S. HRG. 100-774

BUDGET OVERVIEW, 1989

HEARINGS
BEFORE THE
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE
ONE HUNDREDTH CONGRESS
second SESSION

SPECIAL BUDGET HEARINGS
Congressional Budget Office
Department of the Treasury
Office of Management and Budget

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BUDGET OVERVIEW FOR FISCAL YEAR 1989

WEDNESDAY, FEBRUARY 24, 1988

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 10:05 a.m., in room SD–192, Dirksen Senate Office Building, Hon. John C. Stennis (chairman) presiding.

Present: Senators Stennis, Harkin, Mikulski, Reid, Hatfield, D'Amato, Specter, Domenici, and Nickles.

OFFICE OF MANAGEMENT AND BUDGET

STATEMENT OF JAMES C. MILLER III, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

INTRODUCTION OF DIRECTOR MILLER

Chairman STENNIS. Ladies and gentlemen, we will now please come to order.

We have a session in progress on the floor of the Senate, and interruptions may occur. If we have roll calls, particularly, we will have to respond.

We have a wonderful opportunity here this morning to make a record, and also, even more important than that, it is a chance for the members to hear Dr. Miller.

We see fine fruit from the work that was done last year. In my time of hearings, and finally getting a balanced figure out, seldom does it go directly over the next year. But the fruit has been coming in ever since that hearing was held last year. You could feel it at the time that the Executive Branch, both Houses of Congress, both parties, really trying and really cooperating, and they brought forth this proof in the report. It had an immediate value.

I was hopeful, but a little skeptical, too, that the good would extend over to this year. Unquestionably, the work that was done there is still bearing fruit, and it has proven to be a major part of the foundation for getting together concerning the largest budget, the largest dollar-wise as I understand, that we have ever had. That being true, we certainly have to move with dispatch.

Dr. Miller, we are delighted to have you here today. We want to have as much time and such other preferences as you may need or want. I can say that you have been helpful to us already. You seem to be well-prepared to continue that work. I think that we will pretty well follow your advice as long as it goes sailing the way that it is now.

Just a word about the future hearing. Next Tuesday, March 1, the committee will reconvene to receive testimony from the Secretary of the Treasury, the Honorable James A. Baker, III, on revenue estimates, credit reform proposals, the proposed deficit, deficit financing, the growing debt, and the international trade deficit.

The committee will then conduct its final full committee overview hearing on Friday, March 4, with the Acting Director of the Congressional Budget Office, James L. Blum. He will present his annual analysis of the President's budget to the committee.

Again, Dr. Miller, we are glad to have you here. Won't you proceed now, in your own way, in your freedom, and make such points as you desire. Then a big feature of these hearings, comprehensive hearings, is to have these competent witnesses to respond to questions by any member of the committee, anyone who feels the need to ask questions, or come here to hear the questions and answers. It is a great system. We would never get together on things if we didn't have this basic work done.

You proceed now in your own way. We are not going to rush anyone, but we don't want to lose any time. This is the No. 1 item for the day for all of us, subject to things that happen on the floor.

Please proceed.

STATEMENT OF JAMES C. MILLER III

Mr. MILLER. Thank you, Mr. Chairman. Let me say what a pleasure it has been to work with you and your staff, and the committee, on these issues. I appreciate very much your welcoming remarks indicating your being pleased with the cooperation that you received from the Executive Branch of government. We look forward to that constructive relationship throughout the year.

I am pleased, Mr. Chairman, and members of the committee, Senator Reid, to be here to discuss the President's fiscal year 1989 budget. The President's budget faithfully carries out the bipartisan budget agreement reached last November. Of course, we are talking about the major parameters of the budget. Within the ceilings for discretionary spending, of course, we want to suggest some priorities.

DISCRETIONARY SPENDING AUTHORITY

We didn't exceed any of the discretionary budget authority and outlay targets that are specified in the agreement, nor did we intentionally short-change any of the categories. As it turns out, funding for national defense is constrained by both the outlay cap and the budget authority cap. The international affairs spending is constrained by the budget authority cap. The domestic discretionary spending is constrained by the outlay cap. We were off by $100 million when we added everything up, and we almost exceeded the budget authority cap.

ENTITLEMENT REFORMS

Also the President's budget reflects fully the entitlement reforms agreed to last November. Accordingly, this budget is practically devoid of the numerous entitlement reforms that have marked previous Reagan budgets. But this is as it should be. After all, an agreement is an agreement, and the President, by submitting this budget, is carrying out his side of the bargain.

HIGH PRIORITY PROGRAMS OF ADMINISTRATION

The budget, however, is not devoid of initiatives to carry out high priority programs of the administration. For example, AIDS research, education and treatment would receive $2 billion, a 38 percent increase over fiscal year 1988. The Department of Education's discretionary funding level would increase by $656 million. A substantial increase, 44 percent over the 1988 levels, is also requested for the Federal Aviation Administration's effort to modernize the Nation's air traffic control system.

FUNDING LEVELS FOR OTHER PROGRAMS

Our desire to provide adequate funding for these and other priority programs, and the need to meet the limits of the bipartisan budget agreement, require us to make some hard choices on funding levels for certain other programs. We are proposing reduced funding for some programs and the elimination of funding for others, but this is necessary if we are to fund the high priority programs and remain true to the budget agreement figures.

In the parlance of academia, it is a zero sum game. We can't go up in one activity, unless we go down in something else, or at least go below the overall 2 percent plus FERS and pay we agreed to last November.

FISCAL YEAR 1989 DEFICIT

As a result, the President's budget shows a fiscal year 1989 deficit of $129.5 billion, some $17.2 billion below the estimated deficit for the current fiscal year, and $6.5 billion below the $136 billion maximum set under the Gramm-Rudman-Hollings Act. This deficit estimate is based on projections of moderate growth and moderate inflation over the next 2 years.

ELIMINATING NEED FOR SEQUESTER

Also, enactment of the President's budget would avoid the need for sequester. Although $13.2 billion of loan sales, prepayments, sales of assets, and other adjustments are excluded from this algorithm that comes up with a number that determines whether you have to have a sequester and, if so, how much, our current number, based on those modifications, is $142.7 billion. This is some $3.3 billion below the $146 billion sequester trigger under Gramm-Rudman-Hollings—the $136 billion target plus a $10 billion margin of error.

We believe it is imperative that both the administration and the Congress stick to the bipartisan budget agreement. We must continue to work together to reduce the deficit, and restrain growth in Federal spending.

I look forward to working with you, Mr. Chairman, and other members of the committee in meeting the terms of the bipartisan budget agreement and avoiding a sequester. Furthermore, we hope that a bipartisan cooperation will provide for an appropriate and orderly appropriations process.

In particular, the President would like very much to have all 13 bills presented separately. I know many of you on the committee, if not all of you on the committee, would like to have the completion of 13 separate appropriations bills for submission to the President.

DETAILS OF PRESIDENT'S BUDGET

Now, Mr. Chairman, with your permission and the permission of other members of the committee, I would like to go over some of the details of the President's budget with the help of some charts and materials that I submitted to you in advance.

Mr. Chairman, and members of the committee, the key elements of the President's budget are that it fulfills the bipartisan budget agreement and it meets the Gramm-Rudman-Hollings targets.

AREAS OF INCREASED SPENDING

Within the discretionary targets allowed under the bipartisan budget agreement, there is increased spending for drug interdiction, education and treatment, and increased spending for AIDS research, education and treatment. The education budget, science budget and space budget are all increased.

Law enforcement is also increased. For example, there are additional prisons for those who are incarcerated under crowded conditions. Also increased are hazardous waste cleanup activities and support for the poor and the elderly. Also, I will mention that there is a good deal of increased spending for the FAA air traffic controllers.

Within the discretionary total allowed for in the budget, we have reordered priorities in defense and international affairs to try to maximize and strengthen those programs.

ECONOMIC GROWTH AND MANAGEMENT REFORMS

We believe the budget promotes economic growth and progress by restraining government spending; demonstrates some need for budget process reform; and contains some specific recommendations.

It incorporates some management reforms that we have been implementing. I don't want to say that the management reforms that we have carried out thus far complete the task. There is a lot more that needs to be done. The management report that will be submitted to Congress by the President will outline those initiatives—where we come from, but also where we need to go. Privatization is one of the themes of management reform that we have in the Government.

CONDITION OF ECONOMY

Let me say, this budget is particularly important this year because there is a lot at stake. Right now, we are in the 63rd month of the longest peace time economic expansion in history, and that is considerably longer than the 34 months post-war average that we experienced or the 28 months historical average.

Also I want to say that I think the economy is in very good shape right now compared to some time ago. Inflation rates are much lower.

The latest data we have are for calendar year 1987. Inflation rates are about a third less of what they were in 1980. The maximum prime rate has fallen below 10 percent from over 20 percent. Mortgage rates are down, and the marginal tax rate on a median income family of four is down significantly due to the tax reform that you passed in 1986.

We have also made some important progress in areas where we wanted to have a boost. Real GNP is up at an annual rate over the last several years as compared to years before. Real disposable income per capita is up 70 percent. Manufacturing output is up by 50 percent. Business productivity is up three times what it was 7 years prior to Ronald Reagan coming into office.

Under this budget, outlays will continue to rise, as you see, in a rather standard constant slope in terms of total spending. Receipts will rise and will accelerate slightly in the out-years.

DEFICIT TARGETS

Regarding the deficit targets, as you can see, Gramm-Rudman-Hollings is the dotted blue line. The deficit will also come down, but if you will note, Mr. Chairman and members of the committee, the deficit does not come all the way down to zero in 1993 according to the Gramm-Rudman-Hollings targets. Let me explain that.

The Gramm-Rudman-Hollings Act requires that the next year, the year for which the budget is due, meet the Gramm-Rudman-Hollings target. This budget does meet that target. It does not require that the out-years be met.

We would have met the out-year targets but for the fact that we have the agreement. We were concerned that some might feel, I think without justification, that we had exceeded the limits of the budget agreement if we had proposed changes in 1990 and 1991, et cetera, to get the deficit down. Let me say that, under this budget, there is not a lot to accomplish in the out-years. For example, in 1993, the wedge is at its largest and it is only $23 billion in shortfall.

As you can see here, since 1970 receipts have remained a fairly constant proportion of gross national product, around 18 or 19 percent. Outlays, from time to time, have blipped up, and they blipped up considerably in the early 1980s.

The deficit, at least as a proportion of gross national product, reached a maximum in the year 1983. It came down, and then had another blip in 1986. Since 1986, it has come down quite dramatically as a proportion of gross national product.

RECEIPTS AND OUTLAYS

If you look at page 7, you will see the numbers for receipts and outlays contained here. We have a budget of about $1.1 trillion, receipts of about $900 billion, and a deficit that we anticipate for 1988 of $147 billion.

Receipts of 1989 are $965 billion, total outlays are $1.094 trillion, and we estimate a deficit of $130 billion.

During the year, we anticipate that total receipts will go up by $56 billion, and total outlays will go up by $38 billion for a reduction in the deficit of $17 billion.

As a proportion of gross national product, receipts will remain about the same as last year, 19.2 versus 19.3, but outlays will fall from 22.4 to 21.8 percent of the gross national product. The deficit will fall to 2.6 percent of gross national product, and that is a figure about half the peak reached in 1983. It is also a figure that is about the same as in the later part of 1970s.

NATIONAL DEBT

The national debt is 43.0 percent of the gross national product now. We anticipate it falling to 42.8 percent of the gross national product for fiscal year 1989. That will be the first time in this decade that the national debt as a proportion of gross national product falls.

I am turning now to the bipartisan budget agreement. I want to go over this, Mr. Chairman, because it is the product of all of our work, the long hours of work, and I think that it is so important that we remain faithful to that deal.

As you can see, the budget authority and outlay figures that we agreed to in these three discretionary areas are listed here on the left, and on page 8 of the materials you have. The budget authority and outlays contained in the Federal budget that the President sent to you are listed on the right.

DEFENSE

As you can see, the defense numbers are exactly the numbers that were agreed to. Although we exhausted the budget authority for the international program, because of an outlay mismatch, we did not exhaust the outlays. The outlays are below the numbers that we agreed to.

DOMESTIC AREA

In the domestic area, we almost exhausted budget authority and outlays. There is a slight difference between the budget authority agreed to and the budget authority in the budget. Regarding the outlays, this was our target right here, and after we added everything up, after thousands of decisions that were made, it came out about $100 million short of the target. But we would be willing to go along with the extra $100 million spending if that is what the Congress determines because that, in fact, was the agreement.

PROGRAMMATIC AREAS OF SPENDING

If you look at these four programmatic areas of spending, they are national defense, international affairs, domestic discretionary, and entitlements and other mandatories.

Mr. Chairman, of course, this is what your committee has. The entitlement programs are about half, and the discretionary appropriated amounts are also about half, of the total programmatic budget.

The various component parts, as you can see here, add up to mandatory programs of about $511 billion, and the appropriated amount is the difference between $511 billion and $990 billion for total outlays of $1094, including asset sales and offsetting receipts.

COMPONENT PARTS OF BUDGET

Now, if we could take a very quick look at the various component parts of the budget. Again, the four major components.

This is national defense, and as you can see it will rise consistent with the numbers that we agreed to in the bipartisan budget agreement. Total outlays will rise by 3 percent, and budget authority will rise by 2.8 percent.

The international affairs budget, again consistent with what we agreed to, will rise by 1.6 percent, but outlays will actually fall by 1 percent. That is the second major component.

The third major component is domestic discretionary spending, which will increase outlays by 5.3 percent, and budget authority by 3.1 percent. A component of domestic discretionary is the health research and services area. Outlays will go up by 6.2 percent, and budget authority by 3.5 percent. This is increased funding for NIH, for example.

In the space and science area, outlays will face a significant increase, 20 percent, and budget authority is up even more, 29.3 percent. The reasons are primarily the space station and the National Sciences Foundation's budget which we propose to double over a 5-year period.

The next area, economic subsidies and development, will take a small reduction in budget authority, but an increase of 4.2 percent in outlays.

Law enforcement and other core functions of government will rise by 7.5 percent in outlays, and 11.3 percent in budget authority, to accommodate more prisons for those incarcerated in very crowded conditions, and to increase our programs of enforcement of the drug laws.

Transportation and public works will experience a 12.7 percent reduction in budget authority, but outlays will remain constant. This masks the fact that there is a substantial increase for the Federal Aviation Administration air traffic control system, and a reduction in UMTA and in AMTRAK.

Education and social services will go up 3.7 and 3.6 percent respectively with respect to budget authority and outlays.

As you can see, the component parts of the domestic discretionary account on page 20 add up to about $169.1 billion.

ENTITLEMENT PROGRAMS

The next presentation concerns the entitlement programs.

Chairman STENNIS. Excuse me just a minute, before we put up all these charts.

It seems to me that you have fine charts there, and you made a good explanation of them. But the members here can't get you to come and help them read them again. Is there some way that we could devise here that would be put into the record where any member, anyone on the staff, or anyone else could read from that record, and also have a record of your testimony. In that way, you would get your message to them. It is a basic fact that is so important.

BUDGET CROSSWALK

Mr. MILLER. I thought one thing in particular might be helpful. You tell me, and I will abide by whatever decision you make. I have some charts that are not part of our original publications. Those are charts that cross-walk the President's budget into each of the 13 appropriation bills.

I submitted that material to you last evening. We have this in chart form, if you would like to see it. It is material that I have never presented in 3 years that I have been there, and I think in the years before have never been presented to you.

I know that many of you are concerned about the breakout by appropriation measures. We, therefore, did this cross-walk. We will be glad to show you that—it would be 13 additional charts—if you like. But if you would prefer, I would be glad to sit down and respond to your questions.

Chairman STENNIS. That is very fine. I really believe that something should go in the record. It is what the membership will profit by, and it is certainly entitled to look at it and go through it. Before we recess, if we could agree on what goes in and how it should be handled that will satisfy me.

Mr. MILLER. I will be more than happy to submit all of this material for the record if you wish to include it in the record.

Senator DOMENICI. Mr. Chairman.

Chairman STENNIS. Yes.

Senator DOMENICI. I don't want to see the charts either, if that is your pleasure, but might I ask him a question about the crosswalks that he just described?

Chairman STENNIS. Yes. You will make it brief, I am sure.

Senator DOMENICI. Yes, I will.

Chairman STENNIS. We have to move forward to cover all of the testimony while we have this time.

Senator DOMENICI. I will be very quick.

Are you saying that you took the summit agreement on domestic discretionary spending, where you had a total of budget authority and a total of outlays, and you took the 11 domestic appropriation bills, with their traditional jurisdictions, and you assigned to them the ups and the downs of the President's budget? In other words, you have actually allocated to the subcommittees on the basis that, if they adopted the President's budget, this would be the amount of money in each subcommittee in budget authority and outlays?

Mr. MILLER. I think we are saying the same thing, Senator. The President's budget reflects the bipartisan budget agreement. Then we took the allocations in the President's budget, and we cross-walked them for your committee, the Budget Committee, from the President's budget into functional accounts. This is the presentation that I made before the Budget Committee. We also cross-walked it to the 13 bills.

What you said is correct. If Congress were to approve the President's budget the numbers that I have in those charts, and accompanying tables, would be the numbers that would be enacted.

ENTITLEMENTS

Senator DOMENICI. My last question. With reference to entitlements that we have to appropriate, I assume that you just carried them forward into the subcommittee as entitlements, unless you have recommended reductions.

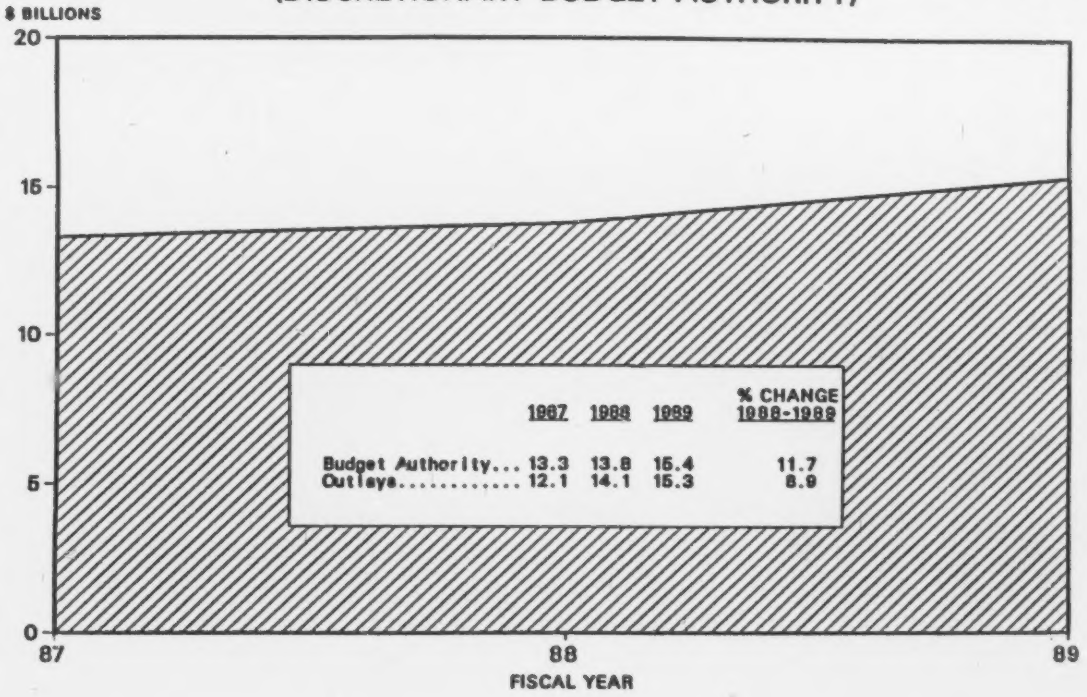
Mr. MILLER. That is right. It was current services for the mandatories.

Senator DOMENICI. Thank you very much.

Chairman STENNIS. We have an uncertainty about being called to the floor several times. So let's utilize this time the best we can, while we have control of it. I think that we can get together on something to go right into the record. You have already made a statement that you would offer charts for that purpose.

[Charts provided by Mr. Miller follow:]

COMMERCE, JUSTICE, STATE, THE JUDICIARY, AND RELATED AGENCIES
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	13.3	13.8	15.4	11.7
Outlays............	12.1	14.1	15.3	8.9

COMMERCE, JUSTICE, STATE, THE JUDICIARY, AND RELATED AGENCIES

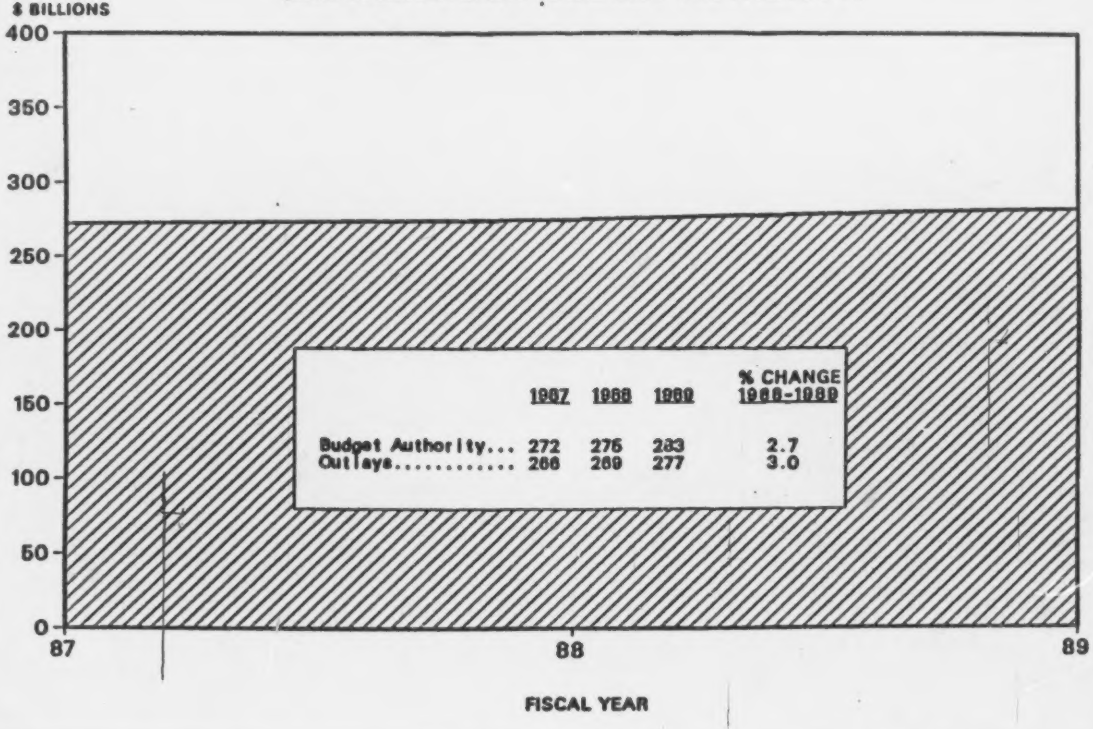
(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Defense Discretionary:				
Budget Authority	0.0	0.0	0.1	0.0
Outlays	0.0	0.0	0.1	0.0
International Discretionary:				
Budget Authority	3.6	3.7	3.8	3.0
Outlays	3.2	3.8	3.9	1.8
Domestic Discretionary:				
Budget Authority	9.7	10.1	11.5	13.7
Obligation Limitations	*	*	*	1.3
Outlays	8.9	10.3	11.4	11.0
Total Discretionary				
Budget Authority	13.3	13.8	15.4	11.7
Obligation Limitations	*	*	*	1.3
Outlays	12.1	14.1	15.3	8.9
Entitlements:[1]				
Budget Authority	0.2	0.2	0.2	13.1
Outlays	0.2	0.2	0.2	13.1
Credit Reform:				
Budget Authority	N/A	N/A	0.4	N/A
Outlays	N/A	N/A	0.1	N/A

---

*Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.



DEFENSE
(DISCRETIONARY BUDGET AUTHORITY)

	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	272	276	283	2.7
Outlays.............	266	269	277	3.0

3

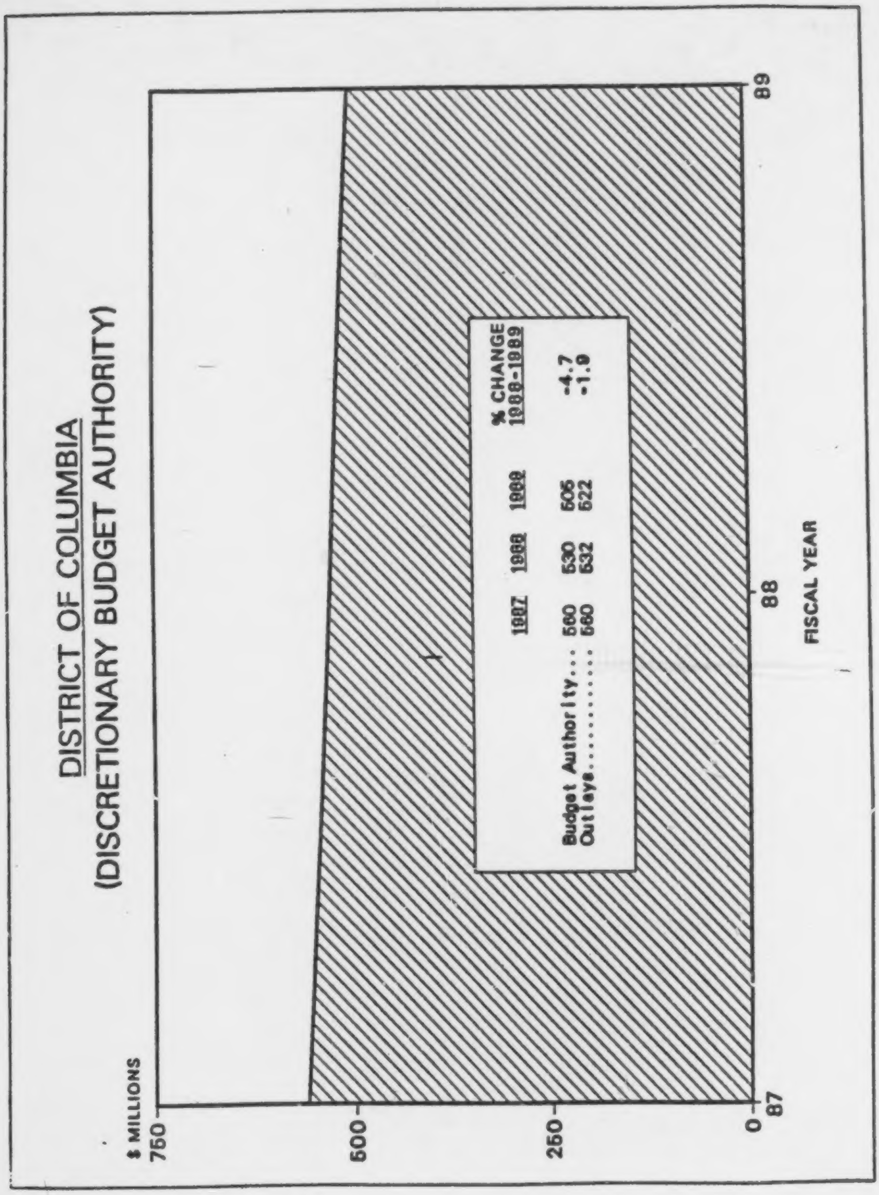
DEFENSE
(In billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Defense Discretionary:				
Budget Authority	272.0	275.2	282.5	2.7
Outlays	265.9	269.4	277.4	3.0
Domestic Discretionary:				
Budget Authority	0.1	0.0	0.0	0.0
Outlays	*	0.0	0.0	0.0
Total Discretionary				
Budget Authority	272.1	275.2	282.5	2.7
Outlays	265.9	269.4	277.4	3.0
Entitlements:[1]				
Budget Authority	0.3	0.3	0.1	−56.0
Outlays	0.3	0.3	0.2	−53.0

---

*Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.



DISTRICT OF COLUMBIA
(DISCRETIONARY BUDGET AUTHORITY)

	1987	1988	1989	% CHANGE 1988-1989
Budget Authority....	560	530	505	-4.7
Outlays.............	560	532	522	-1.9

5

DISTRICT OF COLUMBIA
(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Domestic Discretionary:				
Budget Authority	0.6	0.5	0.5	– 4.7
Outlays	0.6	0.5	0.5	– 1.9
Entitlements:[1]				
Budget Authority	*	*	*	0.0
Outlays	0.0	*	*	–77.7

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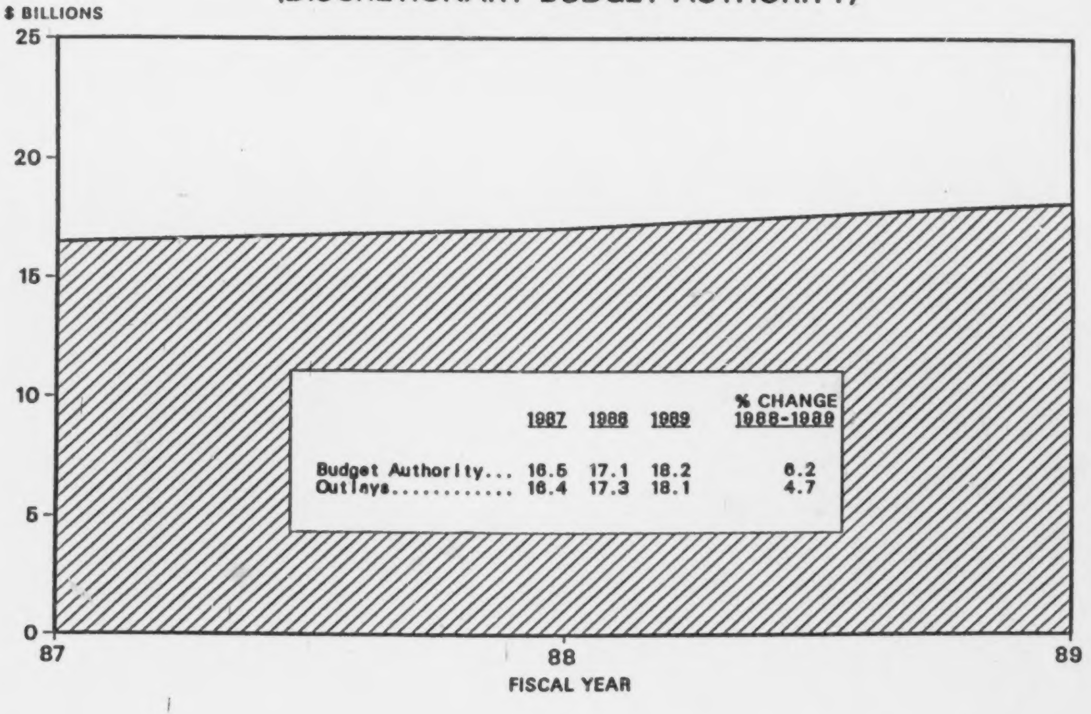
* Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.

ENERGY AND WATER DEVELOPMENT
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	16.5	17.1	18.2	6.2
Outlays.............	16.4	17.3	18.1	4.7

ENERGY AND WATER DEVELOPMENT
(In billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Defense Discretionary:				
Budget Authority	7.5	7.7	8.1	4.5
Outlays	7.5	7.6	7.9	4.1
Domestic Discretionary:				
Budget Authority	9.0	9.4	10.1	7.5
Loan Limitations (Direct)	0.0	*	*	−66.6
Outlays	9.0	9.7	10.2	5.2
Total Discretionary				
Budget Authority	16.5	17.1	18.2	6.2
Loan Limitations (Direct)	0.0	*	*	−66.6
Outlays	16.4	17.3	18.1	4.7
Entitlements:[1]				
Budget Authority	−1.3	−1.3	−1.3	−3.8
Outlays	−1.3	−1.3	−1.3	−3.8
Credit Reform:				
Budget Authority	N/A	N/A	−0.1	N/A
Outlays	N/A	N/A	*	N/A

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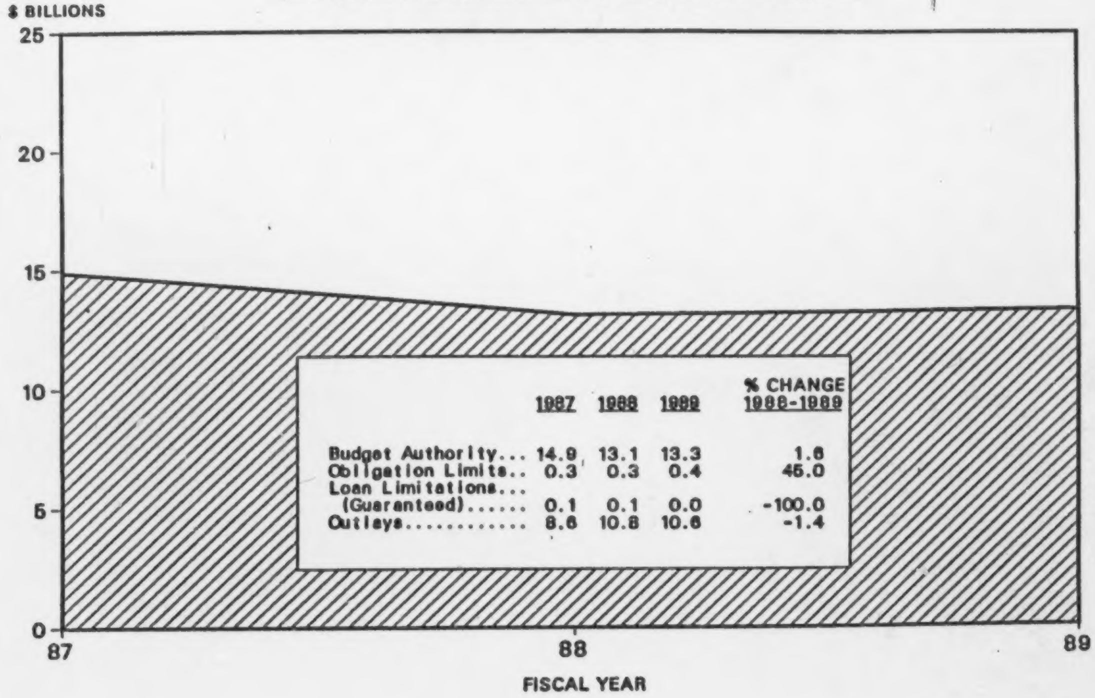
*Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.

FOREIGN OPERATIONS
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	14.9	13.1	13.3	1.6
Obligation Limits..	0.3	0.3	0.4	45.0
Loan Limitations... (Guaranteed)......	0.1	0.1	0.0	-100.0
Outlays.............	8.6	10.8	10.6	-1.4

FOREIGN OPERATIONS
(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
International Discretionary:				
Budget Authority	14.9	13.1	13.3	1.6
Obligation Limitations	0.3	0.3	0.4	45.0
Loan Limitations (Direct)	*	*	0.0	−100.0
Loan Limitations (Guaranteed)	0.1	0.1	0.0	−100.0
Outlays	8.6	10.8	10.6	− 1.4
Entitlements:[1]				
Budget Authority	*	0.6	*	− 92.8
Outlays	*	*	*	15.4
Credit Reform:				
Budget Authority	N/A	N/A	0.5	N/A
Outlays	N/A	N/A	0.2	N/A

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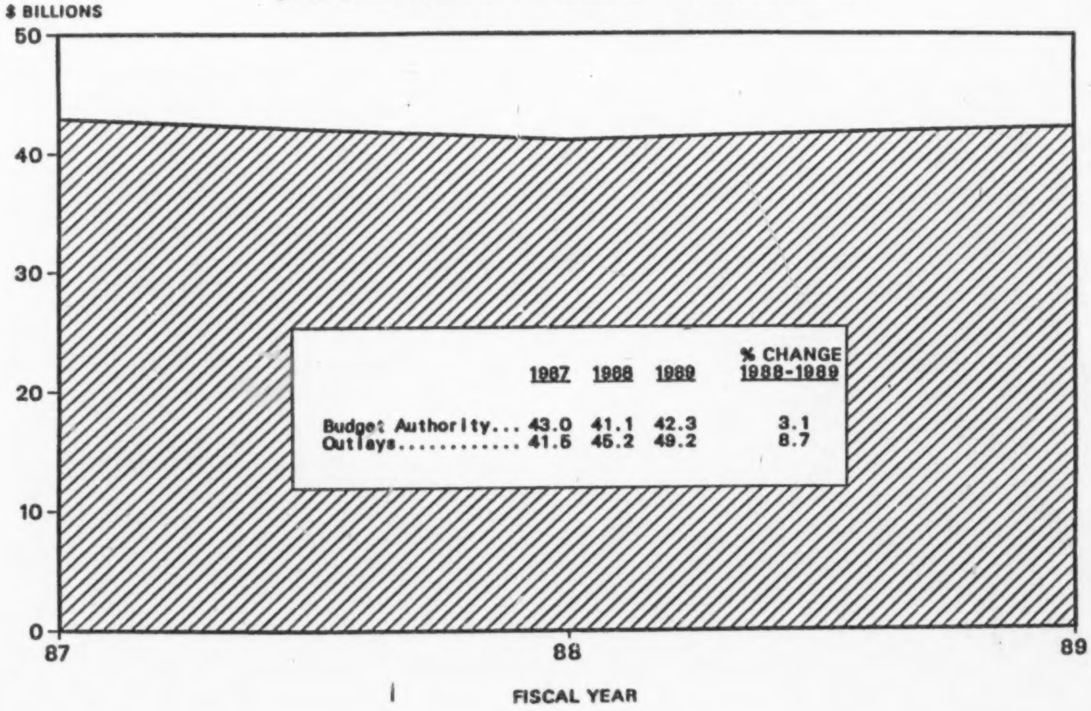
*Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.

HUD - INDEPENDENT AGENCIES
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	43.0	41.1	42.3	3.1
Outlays............	41.6	45.2	49.2	8.7

HUD - INDEPENDENT AGENCIES

(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Defense Discretionary:				
Budget Authority	0.3	0.3	0.4	6.9
Outlays	0.3	0.3	0.4	5.2
Domestic Discretionary:				
Budget Authority	42.6	41.1	42.3	3.0
Obligation Limitations	*	*	*	5.3
Outlays	41.2	44.9	48.8	8.8
Total Discretionary				
Budget Authority	43.0	41.4	42.7	3.1
Obligation Limitations	*	*	*	5.3
Outlays	41.5	45.2	49.2	8.7
Entitlements:[1]				
Budget Authority	15.3	15.4	16.4	6.6
Outlays	15.6	15.6	16.3	4.7
Credit Reform:				
Budget Authority	N/A	N/A	3.7	N/A
Outlays	N/A	N/A	2.3	N/A

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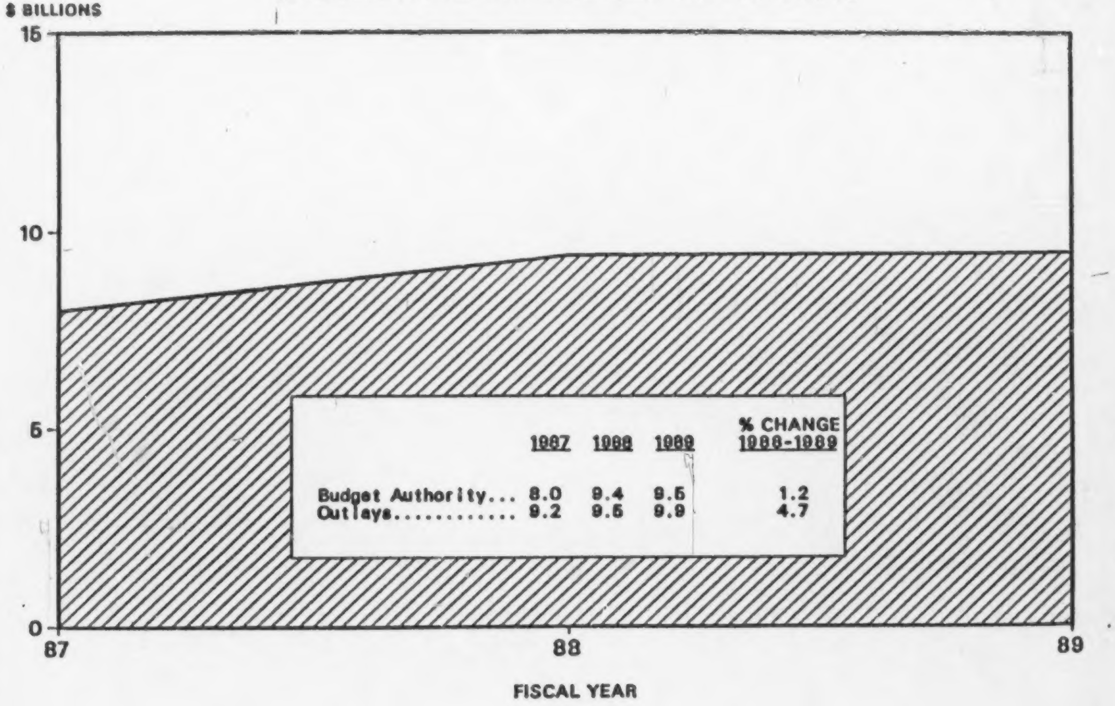
*Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.

INTERIOR
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	8.0	9.4	9.5	1.2
Outlays............	9.2	9.5	9.9	4.7

INTERIOR
(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Domestic Discretionary:				
Budget Authority	8.0	9.4	9.5	1.2
Outlays	9.2	9.5	9.9	4.7
Entitlements:[1]				
Budget Authority	0.2	*	*	0.8
Outlays	*	*	*	1.8
Credit Reform:				
Budget Authority	N/A	N/A	*	N/A
Outlays	N/A	N/A	*	N/A

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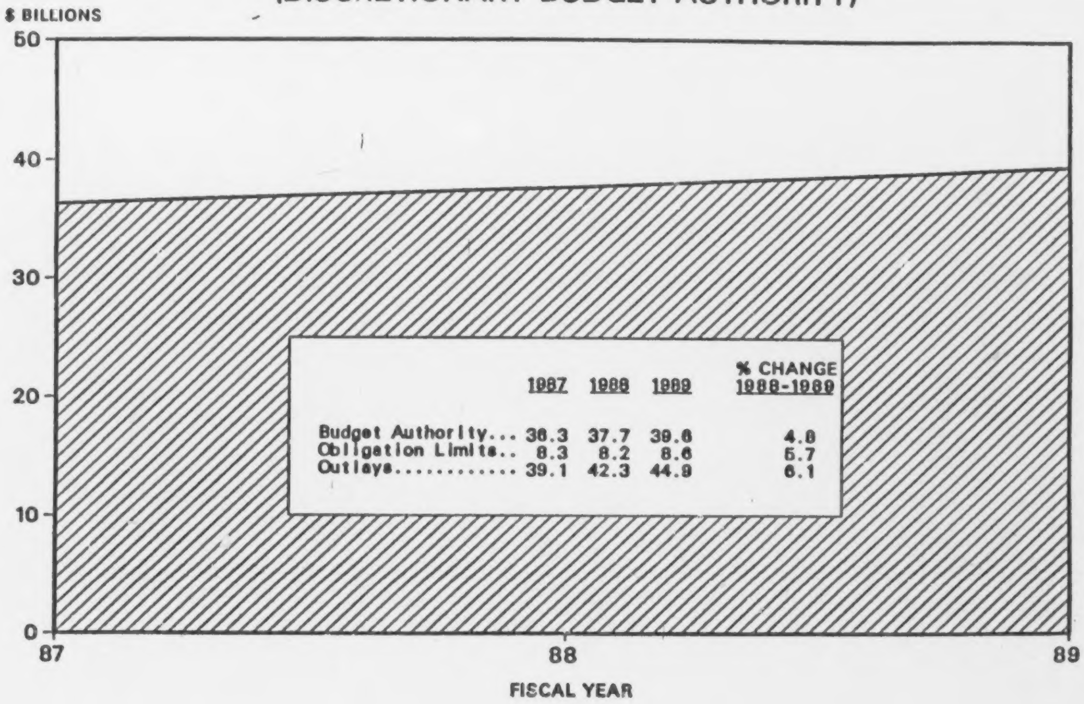
*Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.

LABOR, HEALTH AND HUMAN SERVICES, AND EDUCATION
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	36.3	37.7	39.6	4.8
Obligation Limits..	8.3	8.2	8.6	5.7
Outlays.............	39.1	42.3	44.9	6.1

LABOR, HEALTH AND HUMAN SERVICES, AND EDUCATION

(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
International Discretionary:				
Budget Authority	*	*	*	−21.6
Outlays	*	*	*	−21.3
Domestic Discretionary:				
Budget Authority	36.3	37.7	39.6	4.8
Obligation Limitations	8.3	6.2	8.6	5.7
Loan Limitations (Direct)	*	*	*	−47.8
Outlays	39.1	42.3	44.9	6.1
Total Discretionary				
Budget Authority	36.3	37.7	39.6	4.8
Obligation Limitations	8.3	8.2	8.6	5.7
Loan Limitations (Direct)	*	*	*	−47.8
Outlays	39.1	42.3	44.9	6.1
Entitlements:[1]				
Budget Authority	80.0	90.3	97.6	8.0
Outlays	80.0	90.2	98.0	8.6
Credit Reform:				
Budget Authority	N/A	N/A	3.1	N/A
Outlays	N/A	N/A	2.5	N/A

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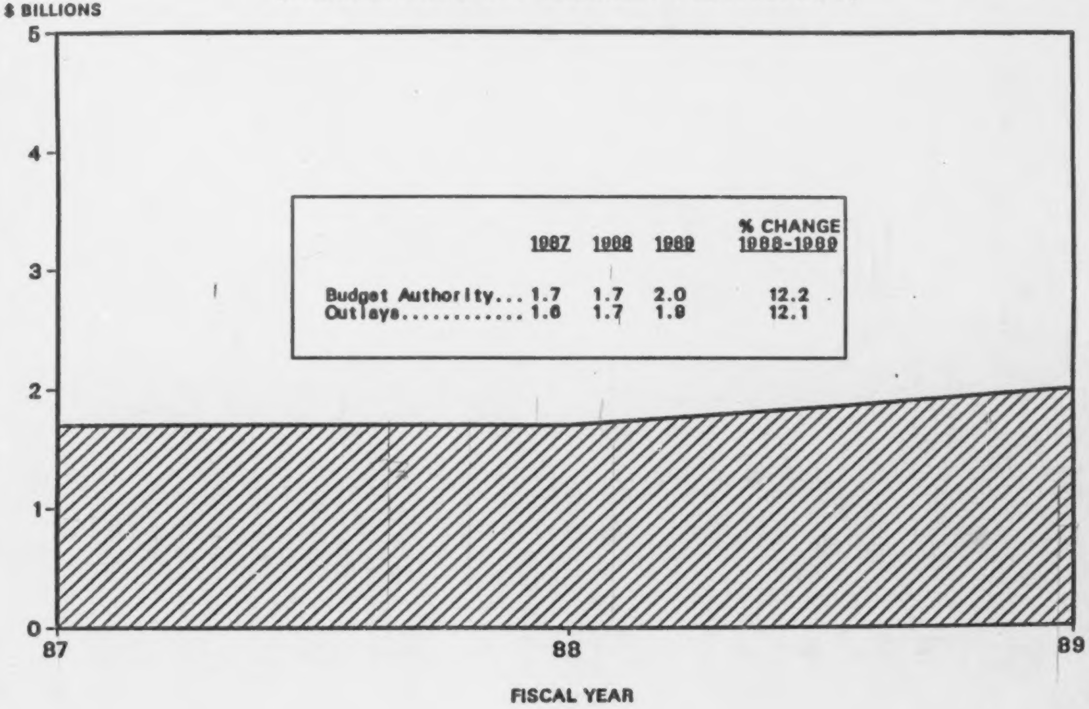
*Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.

LEGISLATIVE
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	1.7	1.7	2.0	12.2
Outlays...............	1.6	1.7	1.9	12.1

LEGISLATIVE
(In billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Domestic Discretionary:				
Budget Authority	1.7	1.7	2.0	12.2
Outlays	1.6	1.7	1.9	12.1
Entitlements:[1]				
Budget Authority	0.1	0.1	0.1	1.4
Outlays	0.1	0.1	0.1	1.4

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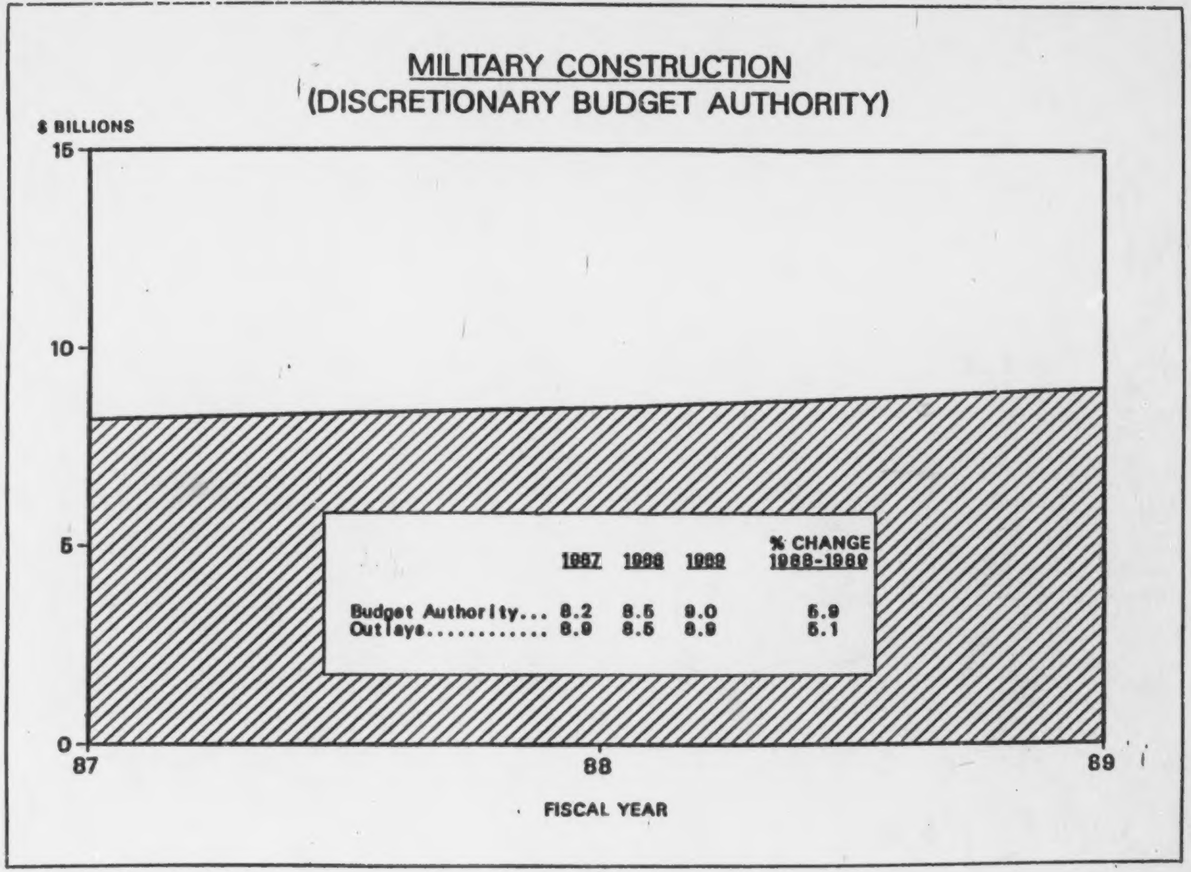
[1] Includes other mandatory programs and offsetting receipts.



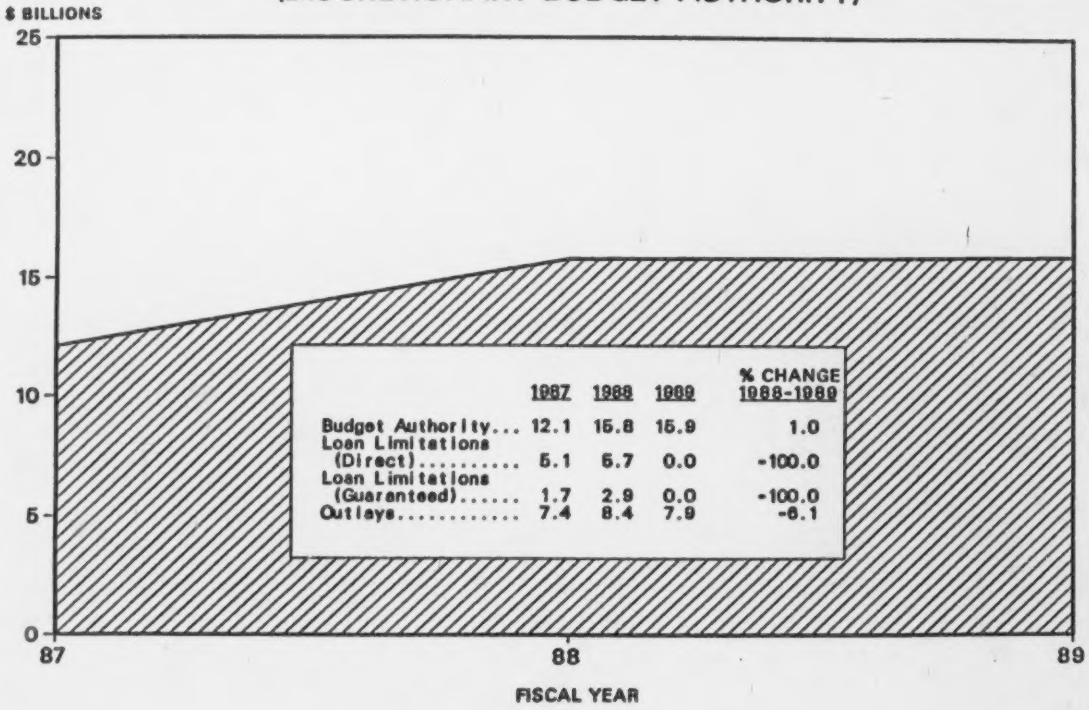
MILITARY CONSTRUCTION
(DISCRETIONARY BUDGET AUTHORITY)

	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	8.2	8.5	9.0	5.9
Outlays.............	8.9	8.5	8.9	5.1

MILITARY CONSTRUCTION
(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Defense Discretionary:				
Budget Authority	8.2	8.5	9.0	5.9
Outlays	8.9	8.5	8.9	5.1

RURAL DEVELOPMENT, AGRICULTURE, AND RELATED AGENCIES
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	12.1	15.8	15.9	1.0
Loan Limitations (Direct)..........	5.1	5.7	0.0	-100.0
Loan Limitations (Guaranteed)......	1.7	2.9	0.0	-100.0
Outlays............	7.4	8.4	7.9	-6.1

RURAL DEVELOPMENT, AGRICULTURE, AND RELATED AGENCIES
(In billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
International Discretionary:				
Budget Authority	1.1	1.1	1.0	−3.4
Outlays	1.0	1.2	1.1	−6.3
Domestic Discretionary:				
Budget Authority	11.0	14.7	14.9	1.3
Obligation Limitations	*	*	*	8.8
Loan Limitations (Direct)	5.1	5.7	0.0	−100.0
Loan Limitations (Guaranteed)	1.7	2.9	0.0	−100.0
Outlays	6.4	7.3	6.8	−6.1
Total Discretionary				
Budget Authority	12.1	15.8	15.9	1.0
Obligation Limitations	*	*	*	8.8
Loan Limitations (Direct)	5.1	5.7	0.0	−100.0
Loan Limitations (Guaranteed)	1.7	2.9	0.0	−100.0
Outlays	7.4	8.4	7.9	−6.1
Entitlements:[1]				
Budget Authority	17.6	18.9	18.5	−2.2
Outlays	19.2	25.6	23.6	−7.5
Credit Reform:				
Budget Authority	N/A	N/A	−0.1	N/A
Outlays	N/A	N/A	−0.1	N/A

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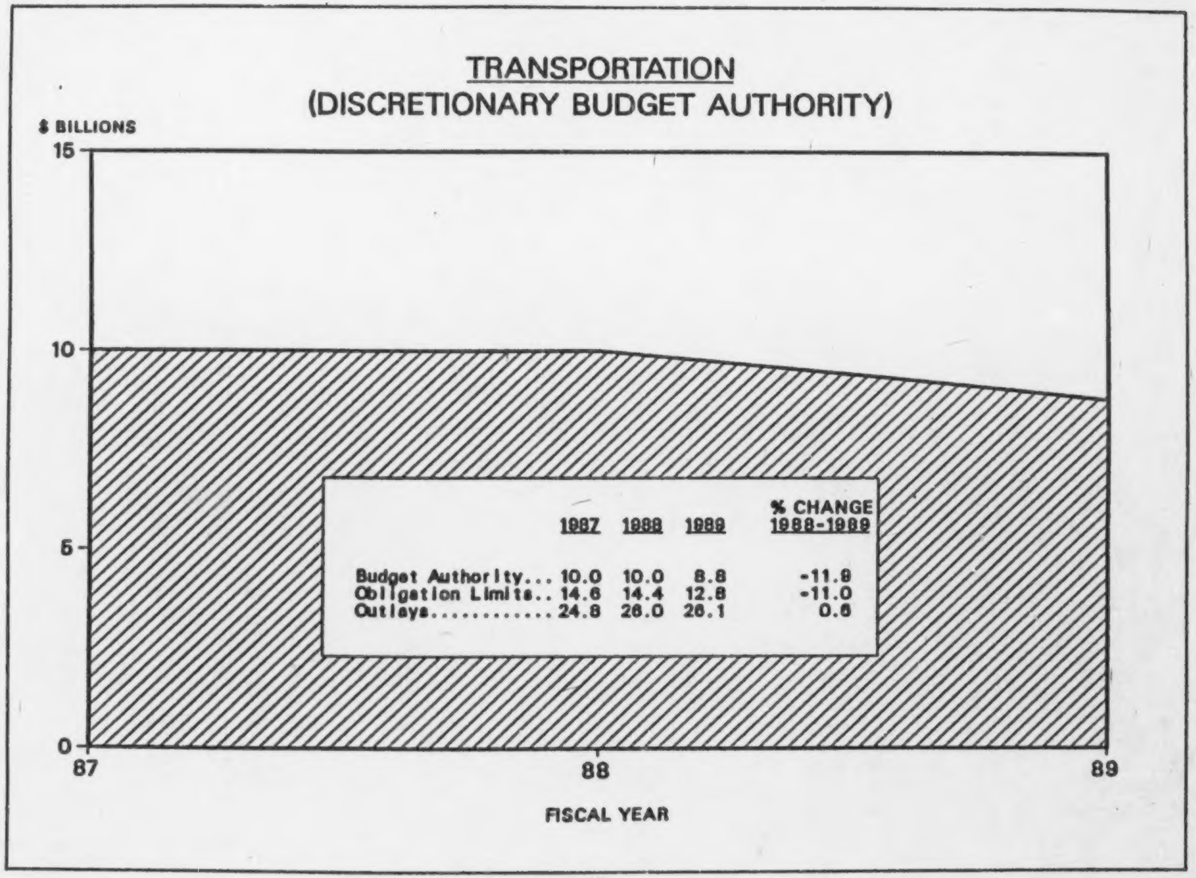
* Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.



TRANSPORTATION
(DISCRETIONARY BUDGET AUTHORITY)

	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	10.0	10.0	8.8	-11.8
Obligation Limits..	14.6	14.4	12.8	-11.0
Outlays...............	24.8	26.0	26.1	0.6

TRANSPORTATION
(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Domestic Discretionary:				
Budget Authority	10.0	10.0	8.8	−11.9
Obligation Limitations	14.6	14.4	12.8	−11.0
Loan Limitations (Direct)	*	*	*	5.3
Outlays	24.8	26.0	26.1	0.6
Entitlements:[1]				
Budget Authority	0.4	0.4	0.4	6.2
Outlays	0.3	0.4	0.4	−3.9

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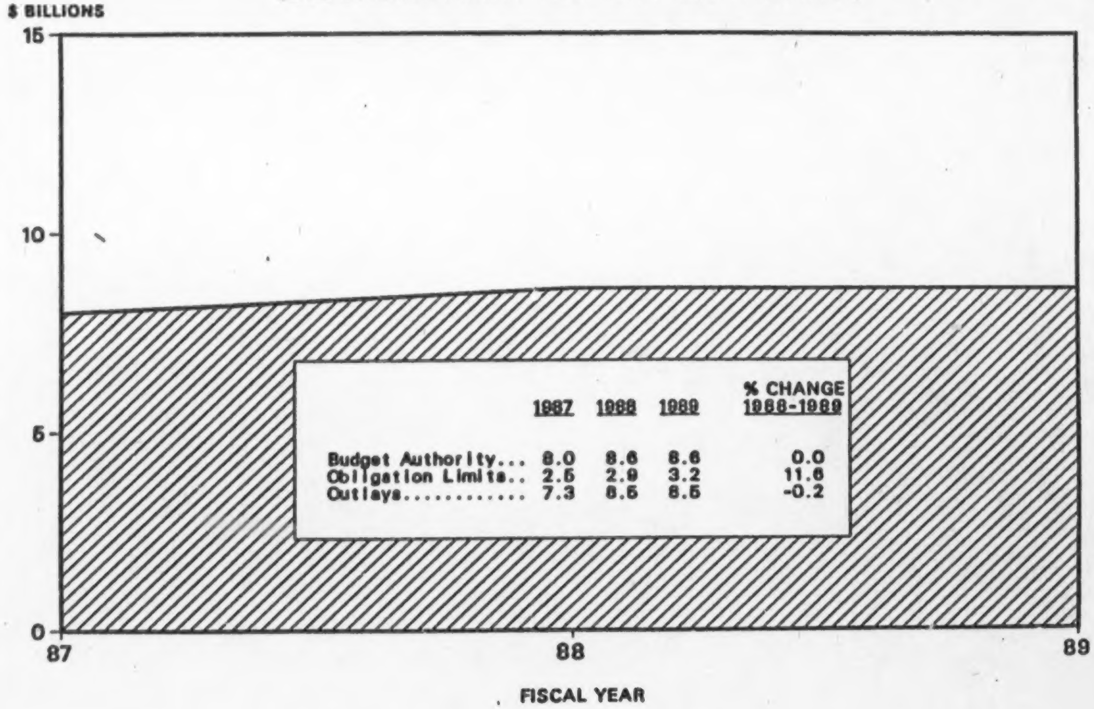
* Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT
(DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	8.0	8.6	8.6	0.0
Obligation Limits..	2.6	2.9	3.2	11.6
Outlays.............	7.3	8.5	8.5	-0.2

TREASURY, POSTAL SERVICE, AND GENERAL GOVERNMENT
(in billions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Domestic Discretionary:				
Budget Authority	8.0	8.6	8.6	0.0
Obligation Limitations	2.5	2.9	3.2	11.6
Outlays	7.3	8.5	8.5	−0.2
Entitlements:[1]				
Budget Authority	6.0	6.5	7.2	11.1
Outlays	6.1	6.8	7.3	6.9
Credit Reform:				
Budget Authority	N/A	N/A	*	N/A
Outlays	N/A	N/A	*	N/A

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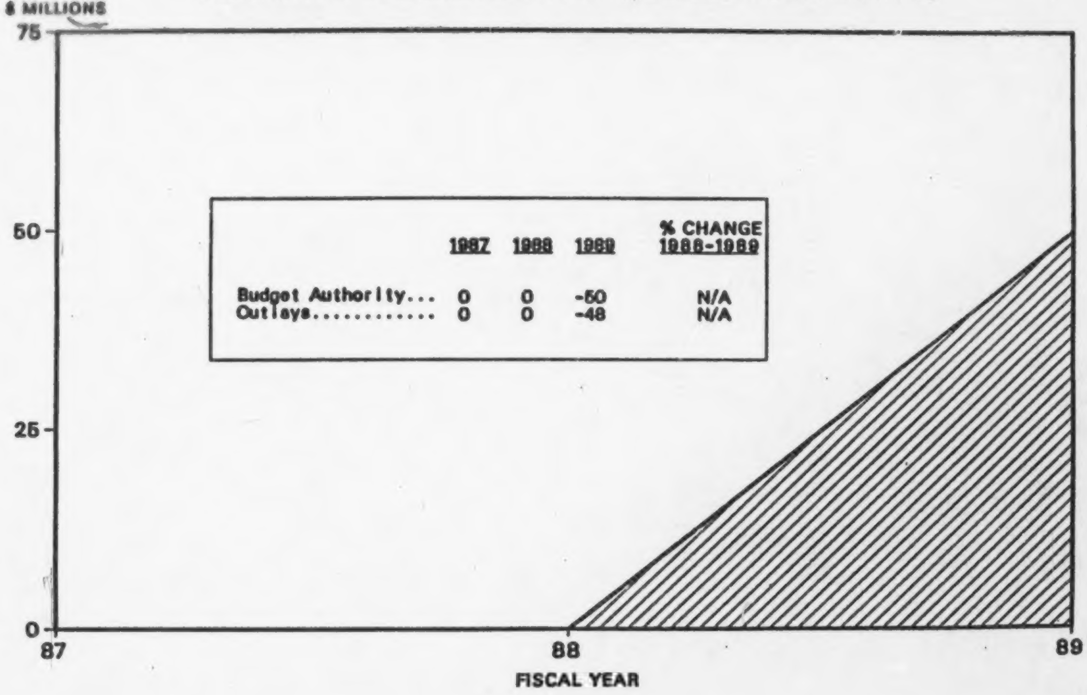
*Amount less than $50 million.

[1] Includes other mandatory programs and offsetting receipts.

UNDISTRIBUTED WITHIN APPROPRIATIONS COMMITTEE
(NEGATIVE DISCRETIONARY BUDGET AUTHORITY)



	1987	1988	1989	% CHANGE 1988-1989
Budget Authority...	0	0	-50	N/A
Outlays............	0	0	-48	N/A

UNDISTRIBUTED WITHIN APPROPRIATIONS COMMITTEE
(in millions of dollars)

	Fiscal Year			% CHANGE
	1987	1988	1989	1988-89
Domestic Discretionary:				
Budget Authority	0	0	−50	N/A
Outlays	0	0	−48	N/A

OPENING STATEMENT OF SENATOR HATFIELD

Mr. **Miller**. Mr. Chairman, could I just say that I think that this material, whether we talk about it here this morning or it goes in the record, is very important. I would like to say, on behalf of the OMB, I hope my successors will continue this because I think this is valuable information for you.

Chairman **Stennis**. I want to call on our friend, the former chairman of this committee. Senator, feel free to take some time, and then we will call on you for questions later.

Let's have it quiet please.

Senator Hatfield.

Senator **Hatfield**. Mr. Chairman, I would ask unanimous consent that an opening statement be placed in the record in order to save time.

[The opening statement of Senator Hatfield follows:]

OPENING REMARKS OF HON. MARK HATFIELD

U.S. Senator From Oregon

Thank you, Mr. Chairman. Mr. Director, it is a pleasure to welcome you here today for your initial defense before this committee of the President's fiscal year 1989 budget. I am sure we will have other opportunities throughout the year to discuss the particulars of the budget as Congress acts upon it, but today I look forward to your presentation of the broad outlines of that budget and your view of where it may lead us in the future.

I want to make a brief statement before we proceed. The President's budget appears to meet the second-year requirements of last year's budget summit agreement, and you are to be commended for that. I can assure you, at least speaking for myself, that I will do everything I can to make sure that Congress upholds its part of that bargain. But there are two matters that concern me greatly.

One is the economic projections on which your budget estimates depend. I hope and pray that your projections are correct, that we will continue to enjoy a relatively healthy economy, and that we will meet the deficit targets of the budget summit agreement. I hope we can quickly adopt a budget resolution in conformance with the budget summit, move 13 separate appropriations bills in the regular order, and be done with our fiscal work by September. No one wants that more than I do. But if your economic projections are in error, we could find ourselves with some very unpleasant choices in August, when the next budget "snapshot" is taken.

We would face more cuts in discretionary programs, protracted arguments with the President about taxes, and further delays in the people's business. I hope you will address this concern.

My second concern has to do with your failure to meet the deficit targets in fiscal years 1990, 1991, and 1992, even with economic projections that are possibly overoptimistic. If this administration, with its well-known reputation for spending and deficit reduction, cannot even propose a budget that meets outyear deficit targets with optimistic economic projections, then I wonder where we will be with a new administration, whether Republican or Democratic. I hope you will address these concerns in your testimony.

Thank you, Mr. Chairman.

OMB/CBO BUDGET FORECASTS

Senator **Hatfield**. I thank you, Mr. Miller, for your fine summary presentation here, and for the documents that you have provided us. I am sure they will be very helpful.

I would like to go on record as indicating a deep concern I have for the rather large variance of projections, including economic forecasts, as between your department and the CBO. I believe the CBO has projected $176 billion deficit for fiscal year 1989.

Mr. MILLER. That is not technically correct.

I think what they projected is what that number would be under the modified Gramm-Rudman-Hollings rules. That number compares with our $142.7 billion rather than our estimate of the deficit, which is $130 billion.

Senator HATFIELD. But on the basis of their projections that would require a maximum $36 billion deficit reduction action, would it not?

Mr. MILLER. It would require a $40 billion sequester. You have to estimate the deficit, and bring the deficit down to the $136 billion.

Senator HATFIELD. I just want to make a record that it does concern me that we have two agencies reviewing this program, and we have that kind of a variance in whatever baseline they are using. It comes back to the long-standing difficulty that we have faced between your office and your predecessors and our own CBO in projections.

I am not going to get into an argument at this point because I am willing to go along at this time with your forecast and support a budget resolution that conforms to the summit agreement, and thereby be able to push for 13 separate appropriation bills, and I don't want to delay the process over forecasts.

Let me merely say that I am skeptical, and I believe that it is important for us to be prepared for the worst. For instance, what if the forecast is wrong?

I know that we don't want to talk about a possible failure of a budget because this is one of the budgets that has come up that didn't get labeled DOA by at least one or more members of the Congress. I think that it is a good way to start, and that is to be together on at least some base lines.

If in August, when we have the snapshot, and this committee has moved ahead, as I expect this committee to do, in preparation for sending the President 13 separate bills, what would you suggest projecting into that particular possibility, accepting a sequestration or convene another summit, even though that might again delay the process of appropriations if we had another summit?

On that basis, Mr. Director, as you know, if we take the sequestration route, we face a 9 percent sequestration in defense, and about a 13 sequestration in non-defense programs.

BUDGET ADJUSTMENTS

I just want to know whether, in the bowels of your agency or somewhere along the line, if you are looking at some possible adjustments that may change the base line upon which we start this appropriations process that would require us to make some further adjustments in the appropriated bills.

Are you looking at these possibilities?

Mr. MILLER. Mr. Chairman, OMB is constantly cranking and looking at numbers and looking at what might be options, but I disagree with the basic premise, that is to say, I do not believe that the CBO number is correct. I do believe the administration's number is correct.

Let me just, as a side-bar, point out that when we came up last year and I sat at this very table, I was asked by members of the committee if our numbers were too optimistic.

As it turned out, our numbers were pessimistic, because the economy performed better than we had anticipated. The reduction in the deficit for fiscal year 1987 was much larger than we had projected.

We used the very same methodology to come up with these numbers as we used last year, and even though they are more optimistic than CBO's and some private forecasters', we believe that they are the correct ones.

I think that it is very important for us to move forward, at least until we are looking at the sequester report next August, to carry out the bipartisan budget agreement, which under our assumptions meets the Gramm-Rudman-Hollings target and avoids a sequester.

Let me hasten to add, Senator, you are absolutely correct. We need to open our eyes to the fact that there could exist next August some bad news, that is to say, we may have to revise economic assumptions to reflect an economy that may not have performed as well as we had thought, or revise our assumptions based on technical adjustments given to us by agencies. In that case, the $142.7 billion number that we have now might go over the $146 billion number and trigger a sequester.

Sequester is something that we ought to avoid. It is in nobody's real interest to do that. We will need to work together. I think the President and the Congress, the leaders, should sit down and work out some alternative to a sequester. That would be my recommendation. But we have not designed a package for that contingency at the present moment.

BUDGET MODIFICATIONS

Senator HATFIELD. You are saying that your on-going process in itself is delaying ground work at least for making a modification, or what might be required, following an August snapshot. Is that what you are saying?

Mr. MILLER. Mr. Chairman, I can say this. I could ask my staff to compile a set of proposals for further deficit reduction and that could be done very quickly. But what the President might want to recommend at that point in time would be up to him. At what time, if any, he would want to make a basic recommendation, again, would depend on whether, I believe, next August it appeared that we were short of the target.

UNCERTAIN ECONOMIC FUTURE

Senator HATFIELD. I would urge you to take a step in that direction in terms of preparing for, perhaps, a different economic picture, especially when Mr. Greenspan, this morning, as reported in the press, in his testimony yesterday somewhere, indicated he felt that the future was very uncertain in looking at the economics of the situation today and trying to project them.

Mr. MILLER. Yes.

Senator HATFIELD. I think that we both, I think, and probably most of the people in this room, would render a judgment of great respect to the ability of Mr. Greenspan and his economic expertise.

I am troubled, as I said, because I got that first flag when CBO put up its analysis, and then, in effect, Mr. Greenspan adding today to the uncertainty. I don't know when we have ever been certain in economic matters, but I think we have to be certainly prepared.

That leads me, Mr. Miller, to an observation that I made at the White House the other morning, when you presented on his behalf the budget for fiscal year 1989, and that is, as we look at these matters identified as wasteful spending by the President, which he used in his state of the Union, the Omnibus Continuing Resolution——

I first of all want to say, if you add up his examples and others that have been referred to over a period of time, they really represent about a hill of beans in a $1.1 trillion spending bill. Every dollar counts, and I would not in any way denigrate the importance of saving any dollar. But I would also say that we ought to keep these matters in perspective.

I would only observe further that in 1989, in this budget, we will be spending more on the interest of the national debt than all the nondefense programs combined.

Secondly, we were well along in our appropriations process, the Senate having reported ten of its 13 bills, with three more ready to go, when the stock market crash that prompted the President's call for a summit.

You came to the negotiating table at that summit on behalf of the administration and asked for two bills. You asked for a reconciliation bill, one, and, two, you asked for an Omnibus CR. In other words, everything was put on hold in the appropriations process.

I want to get down to a very specific question on this whole matter because I would like to lay the groundwork for a future bashing of Congress that the President and others may engage in, and that has to do with congressional initiatives being identified as pork, and presidential initiatives being identified as good government.

For example, Senator Domenici of New Mexico, a few years ago, had an initiative that he added as an amendment to the appropriations with the support of the committee. It related to community irrigation districts in New Mexico and that, being a congressional initiative, would be identified as pork. Then that project turned up on the President's budget, and became "good government."

I do not understand, for instance, why $2 million to the USIA that was added to last year's budget by congressional initiative, or the Oregon Historical Society to help develop the North Pacific Study Center that will add into our whole trade program with Asia, was pork, but $7 million for leather flight jackets for the Air Force is good government just because it was requested by the administration.

With that off my chest, let me ask you how the President intends to follow up on his statement in the state of the Union regarding the list of programs and projects in the 1988 budget that he considered as unnecessary, translating into pork.

Will the President propose formal rescission of those programs, and send a list?

Mr. MILLER. Mr. Chairman, I made notes, and if I may respond to your points, I will try to do that very briefly.

Of course, I have enormous respect for Mr. Greenspan. I once worked for him when he was Chairman of the Council of Economic Advisers. He is correct, there is a great deal of uncertainty.

In fact, I have been told, I haven't done the mathematics myself, essentially, the dispersion in the estimates of blue chip forecasters as an index of uncertainty is much broader today than it was this time last year. I think that is a good indication that there is great uncertainty.

On the pork list, you said a hill of beans, but you are talking about several billion dollars. You will recollect, Senator Hatfield, as well as you, Mr. Chairman, when we sat in those negotiations, how tough it was to find $1 billion in savings.

I remember, the day before we consummated the agreement, spending 5 hours trying to find $1 billion in outlay reductions, and the administration was willing to match it for $1 billion in increased revenues. It was very difficult to do.

INTEREST ON PUBLIC DEBT

We do not spend, unless I have the figures wrong, more on interest this year than on non-defense. Interest on the debt will be $150 billion, approximately, and as I just indicated domestic discretionary spending will be $169 billion.

Senator HATFIELD. Let me interrupt. You said the interest on the public debt.

Mr. MILLER. Including State and local.

Senator HATFIELD. What is that figure?

Mr. MILLER. Interest on the Federal debt is about $150 billion.

Senator HATFIELD. I specifically said, interest on the public debt, and that is listed in a publication here as $220 billion. The net interest, which I think you are referring to, is $151 billion. Are those figures correct?

Mr. MILLER. Yes. The net is the one that matters.

Senator HATFIELD. As I indicated, I used the term, interest on the public debt, and that is the $220 billion which would make my statement correct.

Mr. MILLER. But you didn't include, in your definition of domestic programs, entitlement programs. You just meant domestic discretionary programs.

Senator HATFIELD. I was using the nomenclature used here in the budget from your office.

Senator REID. Would the gentleman yield?

Chairman STENNIS. Just a moment please.

I think that we had better get back on our track here. I would like to see the members have a chance to ask some questions.

Senator REID. Would the Senator yield for a quick question?

Chairman STENNIS. Just a minute, Senator Hatfield is recognized.

Senator HATFIELD. Mr. Chairman, I think the gentleman has a follow-up on part of my question here that he would like to interject. I would be very happy to yield.

Senator REID. Could you explain to me, a new member of the committee, the difference between the $150 billion and the $220 billion figure?

Mr. MILLER. For example, we have loans outstanding, direct loans to people who borrowed money, small businesses, farmers, and so forth, and they pay interest on those loans. So that is calculated into net interest.

Senator REID. Thank you, Senator Hatfield.

Mr. MILLER. Could I say also, you are correct, Senator Hatfield, the way we wound up the negotiations in the budget summit, it was clearly understood that there would have to be two large bills.

At least, let me put it this way, the Congress thought it important that the appropriations be in a CR, and we acquiesced to that, but we didn't expect the CR to arrive 8 hours before we closed down the Government. We would like very much to avoid that in the future, and get the 13 individual appropriation bills.

On Senator Domenici's package, you make decisions about these things seriatim, and some analysis will show, that the program is not justified, and another will show that it is justified. The lists of wasteful spending that we put together included those items that we intially did not ask for that were earmarked into legislation.

NECESSITY FOR AIR FORCE LEATHER FLIGHT JACKETS

Regarding the leather flight jackets, the reason we have asked for a 4.3 percent increase in defense's military pay this year, rather than 2.0, is because we are concerned about maintaining the integrity and efficiency of the volunteer forces, something I know you have worked on in the past. We figured that the leather flight jacket is a means of inspiring esprit de corps and it was a very cost effective way of doing that.

Senator HATFIELD. Basically, then, you are saying, it is in the eye of the beholder.

Mr. MILLER. It is in the eye of the beholder, we could argue about that.

On the state of the Union package that the President will be sending out later this week, we anticipate a package that will identify those items in the continuing resolution that he would have marked through had he had line item veto authority.

It will not address matters that are report language, because we do not believe that the report language is binding on the administration. It will not be in the form of a package of rescissions, but a list.

Let me just tell you, candidly and forthrightly, why that is. The reason is, again, we are bending backwards to have everyone perceive that we are carrying out the budget agreement 100 percent. Arguably, if the President proposed spending less in some of these areas, we would be coming under the targets that we had agreed to in the bipartisan budget agreement.

He is essentially leaving it up to you, Members of Congress, and wishes that you would decide to cut back. The present thinking is that he will not be asking for formal rescissions.

Senator HATFIELD. I will yield to the Chair, as my time is up, but I would suggest to the Chair that, perhaps, before we get the supplemental, that Mr. Miller would give the committee the benefit of his definition of "dire emergency," and that will be utilized to provide a supplemental.

HEARING PROCEDURE

Chairman STENNIS. All right, gentlemen, if I may interrupt. I feel an obligation to the membership that came expecting a 10-minute rule to apply and they would all have a chance to ask questions. If we could go to that now. No one will be cut off for keeps, but if we could go to the 10-minute rule now, I think it will serve a worthy purpose.

The 10-minute rule allows 10 minutes to the members. Someone records them as they come in on an attendance basis. Senator Reid, you were the first one here. We are recognizing you for 10 minutes on that basis now.

Let's have it quiet please.

Senator REID. Thank you, Mr. Chairman.

KEY ELEMENTS OF FISCAL YEAR 1989 BUDGET

I wish we had some of the charts back. I thought you did a good job on the charts. I thought they were very helpful.

Mr. MILLER. Thank you, sir. I have copies, if you want to point out anything, I can look for it.

Senator REID. Mr. Director, one thing that I would like to talk about a little bit is the key elements of the President's fiscal year 1989 budget.

I, of course, recognize the difficult job you have. I know that you get a lot of blame for setting policy, and most of the time you don't do that, you arrange figures to meet policy that someone else gives you.

REDUCTION OF COAST GUARD FUNDING

In spite of that, one of the things that is on your chart is drug interdiction, in response to national priorities and discretionary domestic spending. One of the things, as I understand it, that has been cut significantly is money for the Coast Guard.

You have done a lot of cutting of the Coast Guard. For example, in Nevada there is a facility that is being eliminated on Lake Tahoe, and California and Nevada are concerned about that. But, you also have drug interdiction, and it is my understanding, rather than increasing funding there, you are proposing significant cutbacks.

Mr. MILLER. Let me answer, Senator, and I will try to do so quickly. With respect to the Coast Guard, I have heard it said that the administration cut the Coast Guard budget by $100 million. That is not true. The amount appropriated for the Coast Guard last year was $100 million below what the President asked for last year.

We are asking for a significant increase in the Coast Guard budget in this budget, and we will anticipate, in response to Senator Hatfield's question of the dire emergency, we will not ask for a supplemental for the Coast Guard, but we will be asking for the transfer of funds within the Department of Transportation in order to deal with some of those problems that we have in the fiscal year 1988.

DRUG PROGRAM FUNDING MEASURES

On the question of drugs, every single element of the drug program, save one, will remain the same or increase. Overall there is a several percentage point increase in the amount of money going to the drug program—interdiction, education, and treatment—save one, about $70 million, as I recollect, in grants to State and local governments on the drug program.

This program was originally set up in that one shot 1987 drug bill, and it was perceived that this was seed money to get things going. We think that things are going appropriately, and do not believe that that expenditure is as important as spending that kind of money in other areas of drug enforcement.

Senator REID. What you are saying is that the Coast Guard has not been cut.

Mr. MILLER. Not in this budget.

Senator REID. If there are any Coast Guard cuts, they are being made through agency reprogramming?

COAST GUARD BUDGET

Mr. MILLER. What I am saying is that Congress appropriated, last year, $100 million less for the Coast Guard than the President had asked for in the 1988 budget. In the 1989 budget, the one that we have just sent up, there is a significant increase for the Coast Guard to recover that and more.

Also, to deal with the 1988 problem, we will be, at some time in the future, reflecting dire emergencies, be asking not for increased spending in net, but some transfer of funds within the Department of Transportation to take care of the Coast Guard problem.

DISCRETIONARY DOMESTIC SPENDING

Senator REID. Again, speaking generally and not specifically, I have some problems with the chart; "responds to national priorities and discretionary domestic spending, support for the poor and elderly."

For example, housing is a significant problem in my State. We are a rapidly growing State, and we have a real homeless problem. Homeless problems are not only Eastern problems, they are also Western problems, which place a tremendous burden on State and local governments.

Tell me how the President's budget responds in discretionary spending to support for poor and the elderly?

Mr. MILLER. First let me say, in the entitlement area, of course, there is a great deal of additional support in Social Security, SSI, and other entitlement programs for the poor and elderly. We didn't propose any changes or modifications in the entitlement programs, other than those included in the bipartisan budget agreement.

VOUCHER PROGRAM IN HOUSING AREA

On the other hand, in the discretionary area, what we have proposed are some reforms in some programs to make them better. For example, in the housing area, we propose to go toward use of vouchers. We have found that for the same expenditure of money, you can provide for more homes for elderly and poor, and anyone else, than you can in direct building of government-owned housing.

Senator REID. Mr. Miller, let me interrupt on that statement.

This kind of reminds me of the water shortage problem we have in Nevada. We have people coming to us all the time saying, "but I have water rights." You can have all the water rights in the world, but if you don't have any water, it doesn't do any good to have water rights.

The same applies to this voucher situation. You can have all the vouchers in the world, but if you don't have a place that will take the vouchers, you don't solve the problem. This is a problem we have. These vouchers are floating around, and people won't accept them, so people don't have places to live.

Mr. MILLER. Senator Reid, we have monitored this thing very closely at the Department of Housing and Urban Development. On the whole, we have found that the voucher program has worked out very well. In fact, vacancy rates today are much higher than normal, so people do not have a difficult time on the whole finding places to live with a voucher system.

There remain construction programs in this budget, but for the money, again, we are going to provide 135,000 more vouchers. More families will be housed. In fact, there are more families receiving housing subsidies under this budget than ever before.

TRANSPORTATION AND PUBLIC WORKS

Senator REID. In some of the charts that you had here, and I can't find the place, you had a chart that talked about transportation and public works. It showed relatively level expenditures, if you recall.

Mr. MILLER. Yes.

Senator REID. One of the things that has always concerned me has been the use of the highway trust fund. When I was in the House, we had a vote to take monies out of the trust fund that weren't being spent and spend them. We lost by a few votes on that one.

My question here, on your chart, page 18, domestic discretionary transportation and public works, shows probably a little downgrade there. That chart does not reflect the monies that are in the trust fund that are not being spent. Do you understand the question?

Mr. MILLER. Yes. Could I respond to that?

I had an article in the Wall Street Journal some time ago, and I will be glad to share it with you, which summarized the situation according to my understanding of it.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Honorable Harry M. Reid
United States Senate
Washington, D.C. 20510

Dear Senator Reid:

Enclosed is my Wall Street Journal article on the aviation trust fund that I had promised to share with you during the Appropriations Committee hearing of February 24th. I hope it will answer some of your questions on why the trust fund balance is not being spent more rapidly.

Some of our latest financing estimates further illustrate the point that the so-called penalty provisions have been a major contributor to the growth of the trust fund balance. For example, at the end of 1988, the uncommitted trust fund balance is estimated to be almost $6.0 billion. Because of the penalty provisions, the share of Federal Aviation Administration (FAA) operations financed from the trust fund was $4.0 billion lower than authorized. This shortfall was subsidized by the general taxpayer through the use of general appropriations.

If 1989 operations recovery from the trust fund were to be calculated based on the penalty provision in the 1987 authorization Act, there would be an increase of almost $1.0 billion in the trust fund uncommitted balance. General tax revenues would continue to subsidize this shortfall.

In addition, the trust fund is earning interest paid from general revenues directly into the trust fund. Interest is earned on the entire balance, including those funds that would have paid for FAA operations if the penalty provisions were not in effect.

I hope this is helpful. If I can be of further assistance, please let me know.

Sincerely yours,

James C. Miller III
Director

Enclosure

WSJ
9-15-87

Airport Woes and Trust Fund's 'Surpluses'

By James C. Miller III

There is a deepening suspicion among air travelers that the delays and frustrations they are experiencing at busy airports are the result of a conspiracy—a conspiracy hatched in Washington. Rumors abound that the government is diverting funds earmarked for better aviation to reduce the deficit. That the Federal Airport and Airways Trust Fund has an uncommitted balance of $5.6 billion is often cited as proof that something fishy is going on.

In truth, however, this uncommitted balance, or "surplus," is not a surplus at all. It is an optical illusion created by focusing on the trust fund and not on total spending for federal aviation.

The trust fund was created to finance capital improvements at the nation's airports, to modernize the computers, radars and other equipment used by air traffic controllers, and to defray part of the costs of operating and maintaining the air traffic control system. It also was designed so that those who enjoy the benefits of modern air travel would be the ones to pay, rather than the general taxpayer. Accordingly, the fund's revenues come from an 8% tax on airline tickets, taxes on aviation fuels, and interest earned on cash in the fund.

Understandably, aviation users, who have steadily been paying taxes into the trust fund, would like to know why it has a large and growing uncommitted balance. Contrary to popular opinion, it is not because the administration has been hoarding the money in an attempt to reduce the federal deficit. In fact, fiscal 1987 aviation user taxes of $3.2 billion were less than estimated spending of $5 billion for the Federal Aviation Administration, thereby increasing the federal deficit by $1.8 billion. The trust-fund balance has grown because Congress has forced the government to use general fund revenues—including personal income taxes—to pay for aviation programs, instead of allowing money to be spent out of the trust as intended.

Congress created this situation by putting "penalty provisions" into the 1982 law that authorized the trust fund. First, Congress limited the amount of money that could be paid out of the trust fund to a percentage of funding for airport improvement. Thus, only about 71% of FAA costs could be paid for out of the trust fund, even though several studies have shown that those paying into the fund account for about 85% of that agency's costs. Then, Congress reduced that even further by tying trust-fund spending for operational costs, such as air traffic controllers, to the amount of money spent each year for capital-improvement programs, such as replacing outdated computers.

Although the penalties were intended to keep the trust fund from being used primarily for operating costs at the expense of capital improvements, the restrictions backfired. Because of technological problems, it was not possible to spend all of the money authorized for capital improvements. Moreover, between 1982 and 1987, Congress consistently provided even less funding than the president requested for modernization projects—cutting out $945 million. Therefore—presto—because of the penalties that Congress had built into the law, trust-fund spending for operations also was reduced.

What was the result? Since less money was available to support FAA operating programs from the trust fund, the rest had to come from general revenues. Because the aviation community continued to pay taxes into the trust fund but the government was paying for aviation programs out of other revenues, the government developed a $5.6 billion "surplus" in the trust fund—a surplus more than offset by the $7.5 billion spent out of general revenues to support civil aviation programs during the 1982-87 period.

Over the past six years, the government has spent almost $27 billion on FAA programs. Civil aviation users were responsible for 85% of these costs, or $22.7 billion, but only $15.2 billion was paid from the trust fund—57% of the total. If Congress had made aviation users pay their full share of costs, today the trust-fund balance would be negative. If Congress had provided all the funds for air-system modernization the president requested and had not imposed "penalties," the balance would be only half a billion dollars.

Removing the aviation trust fund from the unified budget—an idea, with some support in Congress, proposed by several aviation interest groups—would be unlikely to accomplish anything for aviation and would confuse the nation's budget picture. The unified budget, as its name implies, should record all receipts and outlays of the federal budget, including trust funds, in order to give an accurate picture of spending, revenues and the deficit. Removal of the aviation trust fund from the budget would violate this principle. The surplus in the fund, as noted above, has not accumulated because of a desire to hold back funding on aviation, and removal of the trust fund from the budget would not guarantee any more spending.

The administration would like to see an end to congressionally mandated bookkeeping gimmickry—by eliminating penalties and requiring that more aviation costs be borne by users rather than the general taxpayer. In addition, we would like Congress to appropriate the amounts requested—nearly a 20% increase for the next fiscal year. Far from wanting to hoard the trust fund to reduce the deficit, we would like nothing more than to spend it on making air travel more pleasant for millions of Americans.

Mr. Miller is director of the Office of Management and Budget.

AVIATION TRUST FUND

Basically what we have is a disagreement between the Appropriations Committee and the authorizing committee. When the Aviation Trust Fund was originally set up—let's talk about it first—it envisioned funding some portion of the FAA's operations out of the trust fund.

The authorizing committee was concerned about the total amount being spent out of the trust fund for certain kinds of development projects, and it installed, essentially, a penalty in there, which says that you can't draw out of the trust fund, you have to draw out of general revenue to finance the FAA's operations. If you recognize that, you recognize that the buildup of the Aviation Trust Fund is, in fact, an artifact of the way Congress has dealt with the trust funds.

The expenditures that would normally go to defray FAA costs have simply come out of general revenues. So there has been a shifting, essentially, of amounts from general revenues into the trust funds. But the operations that would normally be financed by trust fund have gone forward. I will be glad to provide that for the record.

HIGHWAY TRUST FUND

In the Highway Trust Fund, what we are proposing is to spend every nickle that comes in from the highway tax. The penny a gallon that was originally identified for mass transit, that is the amount that we propose go to mass transit. The rest, we would spend it all on highway construction, grants to States, and so forth.

We would not draw down the Highway Trust Fund, however, and we feel that that is an appropriate policy, while we have a time——

Senator REID. Tell me why it is appropriate. I know you are going to share the article with me, but briefly tell me why it is appropriate not to spend those monies that have been set aside for specific purposes in the trust funds?

Mr. MILLER. We will spend every penny that comes in, but we will not draw down the trust fund—that is what our proposal is—because we have a very serious problem on our hands—a very large Federal deficit.

600-SHIP NAVY

Senator REID. One last question. Defense. We heard earlier in the administration about a 600-ship Navy, and all that kind of stuff, and now, as indicated with the resignation of Secretary Webb, it doesn't appear that we are going to be able to maintain some of those things the President ~~talked~~ so much about.

What do we do about that, do we just leave it to the next President, and doesn't it create some problems?

Mr. MILLER. Senator Reid, you are preaching to the choir here.

When we negotiated this last November, I was very strong on higher spending for defense. We were unable to negotiate more than we got. Within the $299.5 billion of budget authority, we had to make some changes because the planning level had been at $330 billion roughly, $333 billion, so we had to come down, we had to come down by more than 10 percent.

When you have to make those kind of changes, you are going to have to make some hard choices, and it wasn't easy. Nobody was enthusiastic about it down at our shop, but we had to make some of those choices, and we cut a little bit here and a little bit there. We cut out some weapon systems. We cut out some current expenditures.

Keep in mind that the way that, basically, we have been doing defense in the last couple of years, when appropriations have not been up to our expectations, we have been stretching procurements out. We have reached the end of our line, so we had to make some tough choices. We would like to have a 600-ship Navy, but we cannot finance it within this budget.

Chairman STENNIS. Thank you.

Senator D'Amato, under the 10-minute rule, I am glad to recognize you, sir.

Senator D'AMATO. Mr. Chairman, I would like to thank you. I would like to thank the deference of my colleague, Senator Domenici, although he is the junior member on the committee, he is certainly senior to this Senator as it relates to his experience, his depth——

Senator DOMENICI. The point is that I was here first, but go ahead. [General laughter.]

Senator D'AMATO. He destroyed all those things I was going to say.

Mr. Chairman, I only intend to take 1 or 2 minutes.

I have to say that I have not been an apologist for OMB. As a matter of fact, Jim, I think I have taken your people on more times than I can recall, and we have had our differences. But I think that you have done an outstanding job under very, very difficult circumstances.

You just have so much food to put on the table. You have an army that comes to be fed, and people don't like their portions. It is a difficult job to prioritize programs, and you have to make some tough decisions.

Let me say this. I am in the midst of preparing legislation to provide that in the case of three or more appropriations bills packaged together in a Continuing Resolution, Congress must reject rescissions proposed by the President within 45 days, otherwise they go into effect. would you be supportive of that?

Mr. MILLER. I would be supportive of that. I think there is a constitutional question that would have to be worked out. I think a simple requirement that Congress vote them would be sufficient. I don't know whether constitutionally—I am not a lawyer, I would have to get advice from the Justice Department—they could automatically go into effect within 45 days. I would surely be supportive of the idea.

Senator D'AMATO. The concept behind the bill is that there would have to be an affirmative congressional action, and this could only be applicable to a packaging of three or more appropriations bills.

Mr. MILLER. Let me say that I support it, with the caveat that I would go further.

Senator D'AMATO. I understand that. But, why go back and revisit a question which will probably result in no action. That is why I thought, using the devastating experience of the Continuing Resolution, we could possibly build a coalition on that.

Mr. MILLER. I hope that we can obtain some budget process reforms of the type that you are talking about.

Senator D'AMATO. One other area, and I will mention it simply to offer my observations, if you would care to respond, fine.

COAST GUARD BUDGET

I understand limited resources, et cetera, but I'd like to follow up on something that my colleague, Senator Reid from Nevada brought up, relating to the Coast Guard. In the fiscal year 1988 budget you asked for a certain amount of dollars, and there was an appropriation of $100 million less.

I think we have to recognize that the dollars came from within the Transportation function. When there is, in total, a situation that cuts mass transit, as this budget does, by about $1.7 billion, it is not realistic, Jim, to think that we are going to cut that $1.7 billion. If you say, take some reductions, fine, but not $1.7 billion. Then the total elimination for AMTRAK, which is $580 million, now we are well over $2 billion in cuts.

Then, obviously, funds will be appropriated for these programs as they have been each year. Mass transit and Amtrak will be funded by Congress for fiscal year 1989. Therein lies the problem between unrealistic budgets and the reality of congressional funding decisions.

While you are correct in saying, no cuts, as it relates to certain areas, in this case the Coast Guard, it is unrealistic to think that such cuts would be acceptable if you are eliminating programs, or making such severe cuts in programs, that you know the Congress, and really the people of this country have said they want to be continued. Therefore, this kind of budget tactics results in a substantial cut in Coast Guard.

I would hope that you would look for a supplemental appropriation in Coast Guard. I think the effort is important. You have recognized that as shown by your prioritizing funding in various areas relating to the drug problem, in terms of education, in terms of AIDS, in terms of additional resources, et cetera.

I hope you would revisit this question. I am not suggesting that mass transportation, AMTRAK, and other programs in this area be held harmless. I am suggesting that you can't put forth a program of almost a total elimination or disproportionate cuts to achieve your results.—It will further erode the ability of the Coast Guard to do its job. I would really hope, in good conscience, that you would look at this.

I am not asking for a long dialogue, this is just a suggestion that I make.

Mr. MILLER. Mr. Chairman, any suggestion that the Senator might have, we would respond to and follow up on.

First of all, we have not put together the transfer yet. We don't know exactly where the money would come from. I can tell you almost certainly that it will not be a supplemental asking for a net increase in expenditures. It will be a transfer of some sort.

Senator D'AMATO. You are going to have a tough time trying to get it out of the Transportation Subcommittee if you are looking to make cuts in the scope that you have put forth. It will result, in my opinion, in a further erosion of the effectiveness and the ability of the Coast Guard to meet its mandate.

Mr. Director, I would hope that you would look at this. This is an area of national interest on which we say we have made a commitment. I would hope that we would follow through. We understand the techniques that are used in this case.

I am not going to say anything further because I would be impinging on the time, the hospitality and the generosity of my colleagues. Again, I say this to you not in an adversarial way, but in the way of saying, let's recognize this problem and see if we can't do a little better to address it. It will continue to crop up, and I don't think that anybody wins by saying, we asked, but the Congress cut back, or vice versa.

Chairman STENNIS. Thank you very much, Senator.

Senator Mikulski, it brings us to you under the 10-minute rule, please, Ma'am.

Senator MIKULSKI. Thank you very much, Mr. Chairman.

COAST GUARD AND MASS TRANSIT

Mr. Miller, it is a pleasure to see you again. You have to know I am somewhat skeptical about economic forecasting. A well-known economist said: economic forecasting gives astrology a good name.

Many of my questions were raised by Senator Reid, particularly the issue of the Coast Guard. But I would like to pick up on some budget considerations and concerns that I have.

First, in the area of mass transit and the Coast Guard. I am concerned that the administration is proposing sharp cuts in mass transit and, in general, function 400 is going to receive less money. My concern is that this means not only less money for mass transit, but the Coast Guard too because it also is in this function, you essentially have Coast Guard, Amtrak, all fighting each other.

Mr. MILLER. That is true.

Senator MIKULSKI. My question is: How do you think we can avoid this process? One, would be more money, so the competition wouldn't be so tight in function 400. Do you have any recommendations in this area; do you think that we should take the Coast Guard out of the transportation function; and, if we moved in that direction, could we look for your support, because it is an agency with a very unique operation?

Mr. MILLER. Function 400 would receive a 1.2-percent increase in outlays, so that is some increase according to the totals that I have here.

I think there is no question but that there is this tension within Function 400, and so within your own Appropriation Subcommittee, between the Coast Guard, Mass Transit, Amtrak, and FAA. What we have is an increase for FAA. We have an increase for Coast Guard. On the other hand, we have a pretty large decrease for mass transit.

Our reading is consistent with the reading of academics, who have looked at this issue, and concluded that large subsidies for mass transit on the part of the Federal Government are grossly wasteful and grossly inefficient. The amount of money that is spent for the ridership is just astronomical. We just could not, in good conscience, propose the levels of money that have been appropriated in the past be appropriated.

Even quite aside from the tension between the Coast Guard and mass transit, and FAA versus mass transit, we simply could not recommend in good conscience that those sums be spent. We do include in there the penny-a-gallon gasoline tax to go to mass transit, but any levels above that we think are wasteful.

We are not out on a limb. This is not an ideological thing. If you ask people in academia and the think tanks who have reviewed this situation, the numbers just jump out at you as reflecting very inefficient spending of funds.

REMOVING COAST GUARD FROM FUNCTION 400

Senator MIKULSKI. We could talk about the funding and the subsidies for mass transit, which I do want to pick up on, but what do you think about taking the Coast Guard out of the Function 400?

Mr. MILLER. I don't think that it makes sense, Senator. I think, generically, Coast Guard is more of a transportation function. You could think that it is part of Justice, or you could think that it is part of Commerce, or something like that, but I think that it is more appropriate as part of transportation. You could even make it part of the Department of Defense. You would have posse comitatus problems.

HIGHWAY EXPENDITURES

Senator MIKULSKI. In terms of mass transit, I think we know that moving people by highway exclusively will not meet our transportation needs. Every time you add a lane to a highway, you create two lanes of transportation capacity.

In bustling areas, like the Washington suburbans we need subways and highways. We have multiple airport needs. We need a good FAA. In the Chesapeake Bay, we need a good Coast Guard. We are really a Transportation-dependent region, and that our needs are worthwhile. Due to competition within Function 400, however, all transportation programs suffer.

CHESAPEAKE BAY

I happen to disagree with you on mass transit, but let's move on to something else that we are interested in, the Chesapeake Bay.

First of all, we would like to thank the President for his continued support for the Bay cleanup efforts. There has been even a modest increase for the EPA Office that oversees the Federal role in the Chesapeake Bay cleanup, and we are most appreciative. At the same time, EPA's construction grants program is being cut, and USDA's Soil Conservation Service, in all probability, will be cut. One of our biggest pollutants in Maryland is the non-point services.

What would you say about this? How would you account for this inconsistency where, essentially, you add money for the thinkers and the scientists on the cleanup of the Bay, but then we cut the programs that deal with the key management issues and the direct pollution aspects of the Bay?

Mr. MILLER. Let me say, you are correct that there are cutbacks in some of the sewer grants. We believe that, basically, this was a program that has been sufficiently funded by the Federal Government. Regarding the soil conservation services, we do take issue there.

Senator MIKULSKI. You put in $70,000 for the EPA office, but then we are going to lose about $63 million in EPA construction grants for Maryland, Virginia and Pennsylvania. We could also lose 30 positions in soil conservation that help farmers reduce the non-point pollution in the Bay.

While we are funding the scientific aspects of research on the Bay, we are actually cutting the programs that curtail pollution in the Bay. We know that the two big polluters, in addition to industrial waste, are non-point sources: agricultural and sewage.

FUNDING FOR SEWAGE CLEANUP

My question is, wouldn't it be cheaper for us to be fully funding construction grants and the Soil Conservation Service. Won't this ultimately get that Bay cleaned up faster?

Mr. MILLER. Again, cleanup of the Bay is not the only consideration in deciding how much money to spend toward some research in this area. In terms of the details, Senator, on the funds for cleaning up the Bay, I will have to get back you in writing, if I could.

[The information follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MAR 14 1988

Honorable Barbara Mikulski
United States Senate
Washington D.C. 20510

Dear Barbara:

This letter follows up on our discussion during my appearance before the Senate Appropriations Committee on Wednesday, February 24, 1988. I promised to provide you with more information on Social Security Administration staffing and the cleanup of the Chesapeake Bay.

On the subject of social security, the Administration is committed to maintaining high quality services to social security beneficiaries. As you know, hundreds of millions of dollars have been appropriated and invested in the Social Security Administration's (SSA's) system modernization plan to achieve cost-effective administrative improvements. SSA's automation and other improvements have increased productivity while improving beneficiary services. For example:

- SSA took six weeks in 1982 to issue social security cards; today it takes ten days.
- In 1987, average processing time for retirement and survivors initial claims was 20 days, down from 24 days in 1984. Also, average processing time for SSI aged claims was 11 days, down from 15 days in 1984. The time required to make emergency payments was reduced from 13 days to five days.
- Local field offices have been given immediate online access to information in the SSA data files, which has provided more accurate and accessible information to the public.
- The 1982 three year backlog in posting wage information has now disappeared.
- Adjustments to beneficiaries' annual earnings records took 48 months in 1982, but only 11 months in 1987.

Beneficiaries have expressed satisfaction with SSA's services. According to the General Accounting Office (GAO) and the Department of Health and Human Services Inspector General, 78-83 percent of clients surveyed found SSA services "good to very good." GAO also found that "key performance indicators continue to show stable performance as staff levels continue to decline."

Continued management improvements in SSA's operations and limiting new initiatives will permit SSA to continue streamlining its staff without jeopardizing service to the public. We look forward to working with Congress to ensure that SSA continues to deliver high quality, cost effective services to beneficiaries.

Regarding the cleanup of the Chesapeake Bay, I am pleased that you support the Administration's efforts. The President's budget continues its support for one of the most important programs for curtailing pollutant loadings in the Chesapeake Bay.

The Environmental Protection Agency's (EPA's) Chesapeake Bay Program provides matching grants to the Bay states for the control of nonpoint source pollution, which accounts for well over half of the pollution in the Bay. The budget includes $10.25 million in FY 1988 and FY 1989, an increase of $1 million over the FY 1987 level. Assistance is provided to identify critical farmlands within sub-basins, develop plans and schedules for implementing Best Management Practices, encourage farmer participation through outreach programs, and develop long-term implementation programs.

The President's budget also funds EPA's program for reducing toxic contamination in the Bay. Components of this program include determining the extent of toxic contamination, assessing the environmental impact, and then implementing point source controls.

In addition, the President's budget includes an increase in FY 1989 of nearly $2 million for EPA's water enforcement programs. The Chesapeake Bay states will, of course, receive a portion of this increase.

The reduction in sewage treatment grants funding for the Bay states is part of an Administration effort nationwide to return responsibility for financing treatment plants to state and local governments. The funding level in the President's budget is sufficient to provide the "Federal share" to fund ongoing "phased/segmented" projects started with Federal funds and to bring all existing plants into compliance with secondary treatment requirements. High funding levels in the past have often delayed, rather than speeded up, compliance with environmental law since municipalities waited to receive Federal grants instead of proceeding expeditiously with cleanups.

Even at reduced funding levels for the sewage treatment grant program, Bay states have discretion to direct Federal funds toward projects that will have the greatest impact on reducing loadings into Chesapeake Bay. Section 216 of the Clean Water Act authorizes each State to draw up a priority list for funding particular projects. Moreover, under the new State Revolving Fund loan program, which is designed to provide a self-sustaining financial mechanism for state and local financing of treatment plant construction, the state can select projects from anywhere on the priority list (CWA Sec. 603(g)).

The Chesapeake Bay also continues to be a high priority for the Soil Conservation Service (SCS). Technical assistance will continue to be provided by SCS for the restoration and protection of the Bay's water quality and living resources. FY 1989 technical assistance funding equals $1.14 million and staffing equals 31 positions for Maryland, Pennsylvania, and Virginia. There are no cuts requested in this area.

I hope that this satisfactorily addresses your concerns regarding Social Security Administration staffing and Chesapeake Bay cleanup. Please do not hesitate to contact me if I can be of further assistance.

Sincerely yours,

James C. Miller III
Director

BAY CLEANUP

Senator MIKULSKI. When we look at it, again, if it is Lee Thomas or President Reagan, we are most appreciative of the efforts in the Bay cleanup. We have absolutely no complaints in that area. In fact, we have nothing but appreciation.

Mr. MILLER. Thank you.

Senator MIKULSKI. But having put the bucks in, after the President's actions put the bucks in, we then have these other funding issues that absolutely undermine the President's earlier action.

SOCIAL SECURITY STAFFING

My last question goes to Social Security staffing. Social Security is located in Maryland. I, of course, have been in close touch with them. What we understand is that Social Security is going to be drastically cutting their personnel. Just as Social Security is cutting its personnel, we are moving into more and more of a demographic change with the aging of America.

Mr. MILLER. Yes.

Senator MIKULSKI. There are going to be more Social Security claims, more processing of Medicare in the field offices, the implementation, hopefully, of our catastrophic health insurance bill. How can the administration justify cutting Social Security personnel with these added responsibilities?

Mr. MILLER. Senator, the answer is that over the past several years, with Congress' approval and encouragement, we have installed billions of dollars worth of data management resources, computers and other data systems, software as well as hardware, in order to process Social Security claims, answer questions, et cetera, much more rapidly.

That whole large program was predicated on there being substantial savings in personnel, and reductions in cost. It was a cost-effective move on the part of the government because, even though we spent billions of dollars on new technology, we also experienced considerable savings in terms of personnel. What we have in the budget is perfectly consistent right down the line with those reductions that were contemplated in that program when it was put in place.

JUSTIFICATION FOR SOCIAL SECURITY CUTS

Senator MIKULSKI. I appreciate that. But GAO, which has monitored this issue for the committee, has never told this committee that Social Security's efforts at automation could maintain the current levels of services and cut personnel this sharply. I would like, as you turn to your staff, if you could provide specific data that would really justify these cuts, I mean that in all sincerity, and particularly at the field service level.

Mr. MILLER. I think that we have some discussion of that point in the budget itself, but we would be glad to respond in a more complete way, Senator, on that matter.

Senator MIKULSKI. Fine.

The Chair has advised me that my 10 minutes have expired. Let me just conclude by saying that I have appreciated working with you, Mr. Miller. We had some prickly issues like drug testing, and I found you to be a very fine professional to work with. As we go through this process, I look forward to the same kind of cooperation.

Mr. MILLER. Thank you, Senator, and I reflect the same sentiments.

Chairman STENNIS. Senator Domenici, under the 10-minute rule, we recognize you.

Senator DOMENICI. Thank you, Mr. Chairman.

BUDGET CROSS-WALKING

Mr. Miller, first let me say that I personally appreciate the one exercise that you did this year, which has never been done before, and that is the crosswalking of the President's budget to the Appropriations subcommittees. Not that Congress is going to adopt them in their entirety, obviously, but it would appear to this Senator that if the Budget Committees, the Appropriations Committees, and the administration could decide early on on the same set of economic assumptions, we would be on the right track. I hope you will urge that course of action, and I will press where I can, that we all agree.

If we choose to use yours, it is my hope that we would all use them, and use them from the beginning. Then it seems to me that your crosswalk to the Appropriations subcommittees becomes a very good working document. If I understand correctly, it will tell us, unless your programmatic estimates are challenged, where your ups and where your downs are reflected in the allocation among the subcommittees.

We have not had that information before. While I am not sure that everybody understands the significance of that yet, I think that it is a very helpful document. Since the budget works off different functions of government than the 13 Appropriations subcommittees, we have left that exercise up to others in the past. It is good to see what your budget does, so that we can determine where the increases should appear by subcommittee.

I don't ask anything from you on this, but for the record, and for the committee members I would say that this is a very unique year in that if the Congress agrees to follow the summit conference, for the first time since we have had a budget process, the domestic discretionary accounts are settled in their totality, with no wiggle room with reference to defense or foreign assistance.

We can't borrow from the other accounts, in the sense of exercising our discretion there. They are fixed, too. So we will have to appropriate within the dollar amounts, with all 11 domestic subcommittees fitting within the total, and that is very different than what we have done before. It makes that exercise relevant, and I personally appreciate it.

BOTTOM LINE NUMBER ON DECREASED PROGRAMS

Having said that, let me ask you. Do you have anywhere in this series of documents a bulk number that would reflect, using whatever baseline you want, current services, or last year over this, a total of how much you propose to increase programs and, thus, how much programs would have to be decreased; is there a bulk number on the domestic side?

Mr. MILLER. I understand your point, and it is a good one. We do not have that tallied up. We have some disaggregation of that. It is a measure of the dispersion.

Senator DOMENICI. I wonder if you might do that.

Mr. MILLER. Yes.

Senator DOMENICI. Mr. Chairman, I wonder if he could submit that to the committee for the record.

Mr. MILLER. I will provide something, Senator, along those lines.

[The information follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MAR 14 1988

Honorable Pete Domenici
United States Senate
Washington, D.C. 20510

Dear Pete:

This letter responds to the request you made during my appearance before the Senate Appropriations Committee on Wednesday, February 24, 1988. You asked for aggregate numbers, for domestic discretionary programs, that reflect "how much (the President's FY 1989 budget) increased programs and, thus, how much programs have to be decreased."

The aggregate increase for accounts proposed to have higher budget authority in FY 1989 than in FY 1988 is $16.0 billion. The aggregate decrease of accounts that have lower proposed budget authority is $11.6 billion. The result is a net increase over the FY 1988 budget estimates of $4.4 billion.

The FY 1989 budget increases programs that the President believes should be priorities of the Federal government. Since we are working under the constraints of the Bipartisan Budget Agreement, increases must be matched by decreases to the extent that the budget totals are equal to or as close as possible to the agreement's totals.

The proposed budget authority total for domestic discretionary programs for FY 1989 is $147.6 billion. This is about $0.5 billion less than the agreement's target. We would be even closer to this target, except for the requirement that the budget also falls within the agreement's outlay cap of $169.2 billion. The budget proposes $169.1 billion in outlays, or $0.1 billion less than the agreement. As I testified on February 24, the administration would not oppose Congress increasing outlays by that amount since the agreement allows for the increase.

I hope that this satisfactorily answers your question. If you have any further questions or comments, please do not hesitate to contact me.

Sincerely yours,

James C. Miller III
Director

ALLOCATIONS

Senator DOMENICI. It seems to me that the committee, right at the outset, ought to know if it is $2 billion or $8 billion, or $1.5 billion, because it has a lot to do with allocations as we go through that process.

Having said that, you know that I have praised your efforts in this year's budget, but I think there are a few cuts that are repetitious. The administration appears to be asking for some cuts that it knows are not going to happen.

POSTAL SUBSIDY

For instance, the administration proposes to once again, wipe out the postal revenue foregone subsidy appropriation, and that accounts for some money that you propose to spend on some of your increases. Everyone should know that if we don't accept that cut of $500-plus million, we have that much less money for the increases that you propose.

Mr. MILLER. Right.

Senator DOMENICI. AMTRAK is another, not that I am complaining. You propose to eliminate it, and Congress has said over and over that they are not going to. Eventually, if we don't, we don't have the increased money for education, AIDS research, science, and the like. At least my rationale is correct that that is what is going to happen?

Mr. MILLER. It is correct.

SUPER-CONDUCTOR/SUPER-COLLIDER PROGRAM

Senator DOMENICI. Specifically, let me ask, with reference to the SSC, the Superconducting Super Collider, you have requested $300-some million for funding.

Mr. MILLER. Yes.

Senator DOMENICI. Could I ask whether, with reference to the accounts which the Appropriations Committee includes within its Energy and Water Subcommittee, you have reduced the non-defense portion of that to any extent to cover the $363 million requested for the Superconducting Super Collider?

Mr. MILLER. Not really. The atomic energy defense portion of the Department of Energy's budget, as I recollect, goes up a very similar amount to the increase for defense, and that is approximately a 3-percent increase in budget authority. Let me just check.

Senator DOMENICI. Specifically, do you, in your budget recommend any cuts to cover the $363 million for the Superconducting Super-Collider, if that is the right number, or is it an actual increase?

Mr. MILLER. It is an actual increase. If you will look at the appropriated amounts for Energy and Water, this is found on pages 7 and 8, you can see that there is an increase of between 1988 and 1989 budget authority of $1.1 billion, and an increase in outlays of a substantial amount. If you give me time, I can find you the specifics.

Senator DOMENICI. That's all right, I don't want to take any more time.

Mr. MILLER. It is not coming out of atomic energy defense or other programs.

ASSET SALES/ENTITLEMENT CHANGES

Senator DOMENICI. My last question has to do with asset sales and/or any entitlement changes that are reflected in your budget, and there are both.

Mr. MILLER. Yes.

Senator DOMENICI. Including such things as the Naval Petroleum Reserves, et cetera.

Mr. MILLER. Yes.

Senator DOMENICI. Might I ask you for your views.

First of all, how important are asset sales to our being able to achieve the Gramm-Rudman-Hollings target of no more than $146 billion when the snapshot is taken in July or August?

Mr. MILLER. You could take out all of the physical asset sales. We have about $3.5 billion of physical asset sales. You could put them off the map, and you would still be below $136 billion according to our estimates, because we are down to $130 billion in terms of that number.

The physical asset sales, as you know, do not count in the algorithm that gives you the $142.7 billion number to compare with the $146 billion number. I would just say that the physical asset sales are not necessary for purposes of meeting Gramm-Rudman-Hollings, so are reflective of good policy, not an effort to keep the deficit down.

Senator DOMENICI. To the extent that we do not do the asset sales, the point is that the deficit will be that much higher. But since they don't count in the sequester calculation, they will not impact on whether we have a Gramm-Rudman-Hollings across-the-board reduction or not?

Mr. MILLER. That is correct. Let me just modify that. There are some asset sales that we agreed upon in the negotiations last November that are included in the Gramm-Rudman-Hollings baseline. As I recollect, the VA loan sales are included in the baseline.

ASPECTS OF ECONOMY

Senator DOMENICI. One last question on economics, and there are two aspects to it. What is happening to the majority of the blue chip estimates as the forecasters look at the American economy for February compared to January? Are they more optimistic or less optimistic?

Mr. MILLER. They have become more optimistic.

Senator DOMENICI. With reference to interest rates, which account for most of the difference between CBO and OMB in terms of calculating the deficit: It appears to me the biggest difference is in their method of estimating interest rates for short- and long-term Treasury bill rates.

Could you tell us what has happened to interest rates in the last 2 or 3 months with reference to Treasury's most recent sales? Are interest rates up or down?

Mr. MILLER. They are down.

Senator DOMENICI. How close are they now to your estimate for next year?

Mr. MILLER. I don't have that information. Again, the progress that we have made since we came out with those numbers in December has been generally in the direction of affirming. All the data, whether it has been the T-bills, or whether it has been the growth data have suggested that we are on the right track. They come closer to our numbers.

ECONOMIC PREDICTIONS

Senator DOMENICI. On that score, we all talk about who is right and who is wrong on economics, and everybody has been wrong, including CBO. What about last year; did OMB turn out to be optimistic or pessimistic? Where did OMB end up with reference to your economic estimates?

Mr. MILLER. We turned out to be pessimistic.

Senator DOMENICI. In other words, the economy performed better than you had estimated when you sent us your budget?

Mr. MILLER. That is correct.

Senator DOMENICI. Thank you very much.

Thank you, Mr. Chairman.

Chairman STENNIS. Thank you, Senator.

All right, this brings us to you, Mr. Harkin.

RURAL DEVELOPMENT INITIATIVE

Senator HARKIN. Thank you, Mr. Chairman.

Mr. Director, the President's budget contains something called a rural development initiative. I fully agree with the concept of a rural development initiative. The rural economy, over the last 8 years, has faced some economic conditions that really have eclipsed the depression years.

I would just point out that rural programs have been reduced 60 percent in real dollars, since 1980, while all other nondefense discretionary programs have only been reduced 25 percent. Actually, that figure is 58 percent versus 25 percent.

Now, the President is responding with a rural development initiative. Let me see if I have it right with this initiative.

This is how it appears to me: First, the rural development initiative reduces specific programs by about as much as one-third. It doesn't propose to terminate any specific programs, but it does reduce them overall by about one-third.

Then the overall budget reduces or terminates almost all of the other rural development programs that don't get mentioned in the initiative.

The initiative reduces rural development programs by one-third. The budget reduces other such programs plus it terminates others.

Please explain how this is rural development.

Mr. MILLER. Senator, when Ronald Reagan came into office, total CCC funding was $4 billion. It reached $26 billion in 1986; a substantial portion of farmers' net income was paid by the taxpayers of America.

That is the biggest rural development, I guess, that any government might have conceived of. If anyone had said in 1980 that the Department of Agriculture's overall programs would exceed $40 billion, someone would have said that you need to go back and look at the figures.

The fact of the matter is that we have a lot of programs at the Department of Agriculture. What the Secretary has done has been to trim those that were not particularly cost-effective, pull together those that were disparate in their effects and in their organization and, in a rural development initiative, utilize the funding and propose that Congress give him the latitude to target those funds where they make the most sense and where they can generate the biggest bang for the buck.

CCC FUNDING IN PRICE SUPPORT PAYMENTS

Senator HARKIN. Mr. Director, I am fully aware of the increase in CCC funding and that is going out in price support payments and things like that.

If you take a look again, most of the payments that have gone out to farmers have, basically, just kept their heads above water. It hasn't represented any increase in income for them whatsoever since 1980.

Basically, it has provided the money for these farmers, to pay their bills for herbicides, for the grain, for the seed, for the fuel, interest rates, which have gone up enormously.

Mr. MILLER. They have come down, Senator. Interest rates have come down remarkably. The prime rate of interest was 21.5 percent in 1980.

VARIATION IN INTEREST RATES

Senator HARKIN. Since when? Don't give me this phony 21 percent. I am talking about the real rate of interest. The difference between the inflation rate and nominal rate has been less, with the exception of last year, greater than it was in 1980.

Mr. MILLER. Do you have those figures?

Senator HARKIN. Sure I do.

Mr. MILLER. Let me say that estimating the real rate of interest is a very difficult thing because it is more than simply describing the difference, the arithmetic difference, in the GNP deflator, for example, and the interest rate being paid. It has a lot to do with expectations and things we don't go into.

There are several theories about that, but I would say that the real rate of interest has remained stubbornly high, but if you will go back and just take that arithmetic computation from the charts that I have in the budget, and have made in the presentation, I think you will be struck by the fact that, on page 3, the difference between 21.5 and 13.5 is, in fact, greater than the difference between 9.2 and 3.7. This suggests that real interest rates, computed by the method that you have just described, are lower today than they were in 1980.

Senator HARKIN. First of all, farmers never got up to 21.5. I think the highest the farmers were paid was maybe 16 percent, something like that.

Mr. MILLER. Then, we would have to have a special series for farmers, and we would be glad to look at that, if you would like, and get back to you.

CCC FUNDING TO MIDDLEMAN

Senator HARKIN. That is aside from the point. I got sidetracked a little bit on interest rates, which we can argue about at some other time.

My point was, basically, that a lot of CCC funding—the megabucks that have gone out there for farm programs—really have not gone to the rural areas. Most of this money has been a pass-through to the large shippers, the exporters, the processors, the handlers, the agri-business community that supplies and delivers the grain or the livestock.

That has been good for them, but, in the meantime most of the infrastructure of rural America has been devastated. We have had a population loss of out-migration, high rates of poverty, loss of farms and loss of jobs. The revenue base on which to support the rural infrastructure has been reduced.

So, when you look at that CCC funding, Mr. Director, that is not rural development money. That money has basically gone, as I said, to the shippers, the processors, the wholesalers, on down the line. It has gone to pay, as I said, interest payments that farmers had to pay on, overpriced land that they buy. That is true, but nonetheless, that is where it went. The money has not helped develop that infrastructure, the roads, the bridges, the business community, the sewers and water, everything else that is needed in rural towns.

BUDGET CUTS IN AREAS OF AGRICULTURE

Let me just read some of the cuts that have been made just in this budget: agriculture research, down 10 percent; EDA, 100 percent, total; Appalachian Regional Commission, down 100 percent.

Those are the direct funding programs. Let's look at the credit programs: REA, 100 percent cut; the agriculture credit insurance fund, the direct farmers home loans, down 50 percent; the Rural Housing Insurance Fund, farmers home housing, which meets the basic needs out there in rural areas, 100 percent phase-out; the Rural Development Insurance Fund, Mr. Chairman, that is farmers home, sewer and water, business and industry, those that go to our small towns and communities in Mississippi and Iowa, down 30 percent.

Those are the budget cuts for rural development programs, and yet I read about a rural development initiative.

Let me read a couple of other figures. In 1987, the unemployment rate in rural counties was 7.2 percent compared to 5.9 percent in metropolitan areas.

In 1986, rural poverty was 18.1 percent while metropolitan poverty rate was 12.3 percent.

We have seen this huge out-migration of people, as I said, leaving a smaller revenue base on which to build this infrastructure.

I looked at this and I said, this is devastating for rural America and I don't understand the rural development initiative. Even if I accept your argument on the CCC funding, I would have to point out that it is going down appreciably in the next 2 or 3 years, too.

Mr. MILLER. Let me respond in several ways, Senator. Number one, let me stipulate from the very beginning, I grew up in a rural community.

Senator HARKIN. Where?

Mr. MILLER. In Conyers, Ga. My grandfather on my mother's side was a blacksmith. He turned to blacksmithing when the weevils got his cotton.

Senator HARKIN. How big a town is that?

Mr. MILLER. The whole county had 3,000 people in it in the 1950s, 3,003 in the 1950 Census. It was a fairly small town.

So, I have some experience with that and I went to school with kids who didn't have shoes.

Let me just go into some of this.

Senator HARKIN. It sounds like some of the places in rural Iowa where I grew up.

TECHNOLOGICAL CHANGES

Mr. MILLER. Let me just say to you, however, that the kinds of secular changes you are talking about do not have a lot to do with public policy. They have a lot to do with technological change.

The fact of the matter is that we have been very good at generating innovative ways of farming in this country, and increasing output. Farming—agriculture—has been the major success story in improved productivity in this Nation and, because of that improved productivity, there is not as big a demand for farm areas as there were before.

In recent years, however, we have seen a turnaround in land prices, which are a good index of what is happening in the rural areas.

You identified a reduction in the direct loan program, but we are picking up loan guarantees. You identified a reduction in direct housing, building and housing, but we are converting, in farm areas, to vouchers.

So, I think, it is one of these things where we are trying to achieve the goals of rural development in these areas and to improve the living conditions and the working conditions there in a very cost-effective manner.

Again, we also have some urban problems, the same kind of difficulties, and it is a set of hard choices that we have to make.

AMERICAN PREFERENCE FOR SMALL RURAL COMMUNITIES

Senator HARKIN. I understand the technological changes. I understand that farming has changed over the years. I am not going to turn the clock back. I wouldn't want to turn it back.

I saw a poll was taken of the American people which asked: Where would you like to live, if you could have good schools, housing and jobs and such, where would you rather live: in a city of over a million; a city of 250,000; or a smaller area?

The vast majority of American people want to live in small communities. They may want to live there but, if they don't have jobs, if they don't have decent housing, if they don't have decent transportation, and they don't have a healthy infrastructure, they can't live in small communities. They are forced to migrate somewhere else.

So, what I am saying is that, sure, you can look at the demise of the number of farmers out there, but that could well be taken up by the proliferation of small businesses, and development centers in rural areas.

But, that won't work either unless we provide some support to prime the pump. You and I may have a philosophical difference on the role of government and that philosophical difference has been going on for eons, but I basically believe that by priming that pump, by providing the kinds of programs that support that infrastructure, we can entice businesses to move there, to develop there, and to employ people in those small towns and communities.

One of my friends who is a farmer in Iowa said: "I don't mind; I don't need all of these other farmers out here. I can farm three times as much as I am farming right now, because of the bigger machinery, better technology and stuff like that."

And he probably can, too. But, tell me this: Who is going to pay to gravel that road? Where are you going to send your kids to school? You bus your kids 5 miles to school now, what is it going to be, 25 miles, 30 miles you are going to bus your kids to school? Who is going to pay your phone bill, your electricity rates, because there is no one else on the line? You are the only person for 10 miles on that electric line; who is going to pay that?

How much is it going to cost you to exist by yourself?

I don't mean to get on a soapbox, and I guess I have a little bit, but I have been disturbed by cuts in these programs that go to the basic, as I keep saying, infrastructure of rural America—it is not just farmers, it is small towns and communities and making sure that we have a climate there where small businesses can develop.

That is what I see happening in a lot of these cuts in this budget.

GRANT PROGRAMS

Mr. MILLER. Let me say also, as you know, Senator, there are very large grant programs. The amount of money that goes from the Federal Government to State and local government is about $120 billion—$119 billion in this budget.

States and local governments have a good deal of discretion over how they use those grants. In fact, we would like to give them more, and we ask Congress all the time to give them more.

The decisions on how to use those taxpayer funds are made at the State level. So, if you look at that increase compared with what you identified as some reductions, there seems to me to be adequate flexibility for your State to utilize those funds in the way that it feels most appropriate.

Senator HARKIN. Thank you, Mr. Chairman.

Chairman STENNIS. Thank you.

Members of the committee, I reserve the right for Senator Hatfield—who really didn't get a chance to finish his questioning in this matter, but had to go to another committee, where he is still detained—and I would like to request for him, the privilege of filing additional questions for the attention of our valued witness. I would like to make that request for myself, too, to submit some questions to you for the record.

Senators Chiles and Burdick were not able to be here this morning due to conflicts with other subcommittees. Additional questions from these gentlemen are on the desk now and I ask unanimous consent that they be filed for the record and I call those to the attention of the witness.

Without objection, those requests are allowed.

CONCLUDING REMARKS

We all want to thank you for your testimony, for your time, for the work you have done over a period of years.

Mr. MILLER. Mr. Chairman, let me just say that this will be the last budget that I will present to this committee. I want to thank you for the single honor of having an opportunity to present three budgets to you.

The President will submit a budget next year, but we won't be testifying on it. We would welcome any opportunity, at any time we can, to help you in any way and work with you toward the goals that we share.

Chairman STENNIS. Thank you very much. We appreciate the value of that assistance and the spirit in which it is offered and given. These problems are real. They concern people in their everyday life, problems of making a living. You have gone through the entire matter, and it represents fine spirit.

We want to go right on and cover these items, not try to rush, but get down to the point where we can make a report. We have the problem still, that I referred to earlier this morning, about getting this proof into the record, make it official, and at the same time available for you and others who are working on it.

Each Member of the entire Congress ought to have direct access to these valuable statistics as well as your opinion about them. So I ask unanimous consent that these matters can be assembled with your assistance, Dr. Miller, and put into the official record.

Mr. MILLER. Thank you, Mr. Chairman.

SUBMITTED QUESTIONS

Chairman STENNIS. Senator Inouye and Senator D'Amato have asked that they be permitted to submit questions for the record. I judge that there is no objection to that. It will be so allowed. All submitted questions and answers will be inserted in the record at this point.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY CHAIRMAN STENNIS

Mr. Miller, the third largest item in the President's FY 1989 budget, after Defense and Social Security, is a $152 billion provision for paying interest on the national debt. Will you briefly explain how this provision has come to be such a large item in the President's budget, beginning with President Reagan's first budget request seven years ago?

Response:

Outlays for the net interest function are estimated to be $151.8 billion in FY 1989. The comparable estimate for FY 1982 in the President's Budget Revisions for FY 1982 was $68.2 billion. Most of this increase is due to the increase in debt held by the public, which increased as a result of the deficits incurred since 1982.

There are other factors that affect interest outlays, such as changes in interest rates and changes in the composition of the Federal debt. Other factors being equal, if the Federal Debt has a longer maturity structure, it is likely to incur higher interest costs since investors require a liquidity premium to lend their money for longer periods of time. The average length of marketable public debt held by private investors has increased significantly since the end of FY 1981, from approximately four years to an estimated six years by the end of FY 1989. This particular increase in the cost of servicing the public debt has been more than offset by the sharp reduction in interest rates achieved by the Administration's economic policies during the same period. The average yield on 20-year Treasury bonds has been reduced from 15.1 percent at the end of FY 1981 to 8.5 percent currently and is projected to decline even further by the end of FY 1989 under the Administration's economic forecast.

Question

Mr. Miller, the President's FY 1989 budget once again proposes the termination or severe reduction in programs which Congress has repeatedly refused to eliminate or reduce because of a sincere belief that these programs are essential to rural or economically depressed areas of the country. Please explain why the President persists in requesting cuts or terminations to such programs as:

- Appalachian regional development programs;
- Community development block grants;
- Urban development action grants;
- Rural water and sewage grants;

and to such government agencies as:

- the Economic Development Administration;
- the Small Business Administration;
- the Tennessee Valley Authority; and
- the Rural Electrification Administration.

Response:

The Bipartisan Budget Agreement set budget authority and outlay caps for fiscal year 1989. The President's budget meets those targets and also provides funding increases for a number of programs identified as priorities. Since we cannot exceed the agreement's caps, many programs identified as low priority or not appropriate for Federal government involvement are decreased.

With regard to the programs and agencies you identified:

Appalachian Regional Commission. The Administration proposes to terminate the Appalachian Regional Commission in 1989. The ARC development programs target resources to rural districts that are no worse off economically than rural communities in other parts of the country and, therefore, are not deserving of special injections of Federal resources.

Community Development Block Grants. The budget proposes to reduce the Community Development Block Grant program, which provides Federal support for cities, counties, Indian tribes, and US territories. With the need to meet additional Federal budget deficit reductions and to hold total Federal domestic discretionary spending growth in 1989 to 2 percent, general community and economic development support was a lower priority than other Federal spending, such as drug abuse reduction and education programs.

Urban Development Action Grants. This program is proposed to be terminated as part of the Administration's effort to cut back categorical local economic subsidy programs that distort economic investment choices and impose Federal priorities on State and local governments.

Sewage construction grants. This program is proposed to be phased out by 1993. The proposed program level is sufficient to fund the Federal share for all projects needed to meet the 1988 municipal compliance requirements, complete all treatment plants started with Federal funds, and give States the flexibility they need to made the transition to financial independence in this area.

Economic Development Administration. The Administration proposes to terminate the Economic Development Administration in 1989. EDA programs do not target assistance to those in need, but instead serve narrow local and regional interests. Furthermore, there is no evidence that these programs create new jobs.

Small Business Administration. The Administration proposes to continue Federal credit assistance to small businesses in the form of guaranteed loans rather than direct loans. Guaranteed loans of $3.6 billion are proposed in 1989 for the SBA general business program, small and minority enterprise business investment company programs, and development company programs.

Tennessee Valley Authority. The Administration would terminate direct support for TVA's regional economic and community development programs, which are more appropriately private or State and local government responsibilities. To the extent that Federal assistance is needed, it is better allocated through programs administered nationally by other Federal agencies. TVA's basic responsibilities for water resources systems management and fertilizer research continue.

Rural Electrification Administration. The budget proposes to substitute partial REA guarantees of private sector loans for the high-cost, deeply subsidized direct REA loans. This reform is appropriate since REA's goal is largely accomplished and nearly all REA borrowers should be able to secure private lending with the partial guarantee.

Mr. Miller, The President's new budget proposes nearly $2 billion in housing and community development spending cuts from current expenditures and calls for elimination of several housing and urban development programs. At a time when we daily confront on our Nation's sidewalks the homeless and the destitute, how can the Administration continue to cut funding for housing and community development programs?

Response:

The President's 1989 Budget calls for spending of more than $13.5 billion on housing and community development. While this figure represents a slight decline in budget authority from the 1988 estimate, 135,500 additional low-income families would receive housing subsidies in FY 1989, approximately an 8 percent increase over what Congress provided in FY 1988.

Since 1980, the Administration has added 1.1 million HUD-subsidized households and 300,000 FmHA-subsidized households to bring the total 1987 assisted housing inventory to 5.6 million households. With program additions in 1988 and 1989, the number of subsidized households will increase to 5.8 million. Our accomplishments during the tenure of this Administration, such as providing rental housing subsidies instead of subsidizing expensive new construction, and providing community development block grants instead of categorical grants, have improved the efficiency with which the Federal government serves the Nation's low-income citizens. At the same time, this Administration's promotion of Federalism has returned to the States the authority and the responsibility to deal with local needs using Federal assistance.

With respect to program terminations, it is true that there are several housing and community development programs that are proposed for termination in 1989. These programs, such as the Urban Development Action Grant program (UDAG) and the Section 312 rehabilitation loan fund are prime examples of Federal programs whose usefulness has come and gone. With respect to the UDAG program in particular, Congress itself has admitted that this program is of increasingly less practical value and has consistently cut the appropriation level from $474 million in 1982 to $216 million in 1988. It's time the Congress took a hard stand on this outdated and inefficient producer of pork projects and terminated it once and for all.

During a time of record deficits and increasing needs for Federal assistance in many areas, limited funds must flow to the most efficient and worthy programs. Finally, with respect to the needs of the homeless, the budget provides $390 million; this represents a 4.3 percent increase over what Congress provided in FY 1988 for Homeless programs.

Question

Mr. Miller, the President's budget projects a deficit for 1989 of $129.5 billion, which falls within the revised target of $136 billion under the new Gramm-Rudman-Hollings law. However, the Congressional Budget Office projects a deficit for 1989 of $176 billion, and thus missing the new target by $40 billion. Please explain why there is such a discrepancy between OMB and CBO over the size of the deficit.

Response:

The CBO projection is their estimate of the deficit in the Gramm-Rudman-Hollings (G-R-H) baseline, not the President's budget. The Administration estimate of the G-R-H baseline deficit in 1989 is $143 billion, $13 billion above the budget. Asset sales, which cannot be counted as savings in the G-R-H baseline, account for $10 billion of the difference between the OMB baseline and the budget. The remaining $3 billion difference is due to a variety of programmatic differences and debt services.

The CBO estimate of the baseline deficit is $33 billion above the OMB estimate of $143 billion. We believe that economic assumptions -- largely interest rates and levels of gross national product and income -- account for $27 billion of the difference between OMB and CBO. Technical estimating differences for both outlays and receipts put CBO $6 billion above OMB. Most of the technical difference for outlays is due to different assumptions about spending for entitlements and other mandatory programs.

Question

Mr. Miller, we hear a great deal these days that the national debt, which presently is projected at $2.8 trillion in FY 1989, has tripled since Mr. Reagan took office in 1981. At that time, the national debt stood at $914 billion. What caused this tremendous increase over such a short period of time?

Response:

It is correct that Gross Federal Debt is projected to reach $2.8 trillion by the end of FY 1989, nearly triple its level of $1.0 trillion at the end of FY 1981. However, nearly $0.5 trillion of the increase in gross Federal debt represents debt held by Government accounts. Another $0.1 trillion of the increase represents debt held by the Federal Reserve. The more appropriate measure of the national debt is debt held by the public other than the Federal Reserve. This figure stood at $0.7 trillion at the end of FY 1981 and is projected to reach about $1.9 trillion by the end of FY 1989. The $1.2 trillion increase is due almost entirely to borrowing required to finance Federal deficits for fiscal years 1982-1989. As shown below, deficits for these eight fiscal years are estimated to total $1.4 trillion. Debt held by the public (including the Federal Reserve) increased by $1.4 billion over the same period.

(in billions of dollars)

Fiscal Year	Federal Deficit	Increase in Debt Held by the Public
1982...........	127.9	135.0
1983...........	207.8	212.3
1984...........	185.4	170.8
1985...........	212.3	197.3
1986...........	221.2	236.3
1987...........	150.4	151.7
1988 est.......	146.7	127.2
1989 est.......	129.5	127.0
Total.....	1,381.2	1,357.7

QUESTIONS SUBMITTED BY SENATOR INOUYE

The unintended side effect of the Administration's unwillingness to support the value of the dollar has been the beneficial effect it has had on the less developed countries, many of which owe substantial dollar denominated debt to United States banks and multilateral lending institutions.

Will this ease the requirement for foreign assistance funding? If not, what impact will it have?

Response:

The decline in the dollar against the currencies of the major industrialized countries will not necessarily ease the requirement for foreign assistance funding. The decline may ease somewhat the burden of those countries with external debt denominated largely in dollars and that earn a high portion of their foreign exchange in non-dollar currencies. However, in other cases, much of the debt owed multilateral lending institutions is denominated in currencies that have appreciated, and so certain countries may have more difficulty servicing their external debt. For these types of reasons, the depreciation of the dollar has mixed effects on U.S. aid recipients. The Administration does not think that the requirements for foreign assistance funding have been eased.

Question

Will the Administration be seeking a revision of its budget accord with Congress through its expected package of rescissions and a possible request for a supplemental appropriation?

Response:

The Administration does not seek a revision of the Bipartisan Budget Agreement. The identification of wasteful, unnecessary, and low priority spending items contained in the full-year Continuing Resolution (P.L. 100-202) does not represent a modification to the accord. This list provides an opportunity for legislators to evaluate and act on the fiscal necessity or appropriateness of certain funding actions.

In his budget message on the FY 1989 budget, the President clearly stated that in submitting this budget -- a budget that does not fully reflect his priorities, nor presumably, those of any particular Member of Congress -- he adhered to the Bipartisan Budget

Agreement and asked the Congress to do the same. This message is no less emphatic now than it was a month ago.

All Executive Branch supplemental requests or rescission proposals will be carefully evaluated to ensure that the Bipartisan Budget Agreement is not breached. The Bipartisan Budget Agreement stipulates that for annually appropriated discretionary spending there are to be no supplemental funding increases except for dire emergencies. Supplemental requests from the Executive Branch will be in full compliance with the Agreement.

The Administration stands behind the Bipartisan Budget Agreement and expects to work fully with the Congress for its continued implementation during FY 1988 and FY 1989.

Question

Non-defense discretionary programs have borne the brunt of budget restraint in the 1980's, declining from almost 6 percent of GNP at the start of the decade to 3.7 percent at present and a projected 3.4 percent in 1993.

In such an austere environment, and with mounting demands on other discretionary portions of the budget, how does the Administration propose to answer the demand of base-rights countries for substantial increases in their share of U.S. foreign assistance?

Response:

The levels contained in the 1988 appropriation and in the President's 1989 budget are sufficient to meet immediate national policy requirements for assistance to the so-called "base-rights" countries. The Administration is exploring approaches to meeting our security requirements in the Philippines in the context of the current base review and upcoming negotiations. We will consult fully with Congress on this issue. It will bear on assistance levels for 1990 and beyond but will not affect the current Bipartisan Budget Agreement.

Question

The CBO projects that "the dollar is likely to fall further" in the coming months. This current cycle of decline in the exchange rate has resulted in a drop in the purchasing power of U.S. foreign assistance, thereby delaying, or otherwise obstructing, our foreign assistance policy.

How would the Administration propose adjusting to this situation?

Response:

The decline in the value of the dollar vis-a-vis other major developed country currencies has affected U.S. foreign assistance in a number of ways. First, in some cases the operating costs of Agency for International Development programs abroad have increased. This has occurred primarily in less developed countries (LDC's) that peg their currencies to non-dollar currencies, such as in francophone African countries. The Administration has endeavored to allocate operating expenses accordingly.

Second, some LDC's that import from countries with appreciating currencies may have more difficulty servicing their trade debts. While the Administration might want to reallocate assistance to take into account severe balance-of-payments problems due to exchange rate shifts, that is not possible in 1988 because the Economic Support Fund, which is best suited for that purpose, is almost entirely earmarked by Congress.

On the positive side, however, many LDC currencies are tied to the dollar. This means that U.S. foreign assistance has not decreased in local terms. Moreover, a depreciating dollar may stimulate exports from these countries, thus helping them to service their external debt more easily. In these cases, no adjustment is necessary.

Question

CBO foresees slower real growth, higher inflation, and higher interest rates during the next two years than does the Administration. The Adminstration, however, has not released all the details of how it arrived at its optimistic forecast.

In light of the October stock-market crash and the CBO projection that the value of the dollar is likely to fall further this year, upon what does the Administration base its optimistic outlook?

Response:

The economic assumptions used for the budget are explained in Part 3 of the budget document and further justified in Chaper 1 of the Economic Report. One should not stress the uniqueness of the Administration forecast, but rather its similarity to CBO's and to other forecasters' projections. All agree that 1988 will see significantly more modest real growth than the 3.9 percent racked up in 1987; in that context the difference between the Administration's 2.4 percent projection of fourth-quarter-to-fourth-quarter real growth and CBO's slightly more pessimistic 1.8 percent is not major. Most forecasters see a rebound in growth in 1989, and in that context, the Administration assumption of 3.5 percent growth in that year is perfectly reasonable; and indeed, it is slightly below the growth rate the Administration projected for 1989 in last year's budget (3.6 percent).

In a decade that has seen interest rates gyrate by ten percentage points, the fact that OMB and CBO forecasts are within one and half percent of each other is practically unanimity. The Adminstration sees the 3-month Treasury bill rate coming down a couple of tenths of a percentage point from its current level of about 5 1/2 percent. CBO sees it rising about 1 1/4 percentage point by the end of 1989 -- somewhat perversely, in the Administration's view, given the general softness of the economy that both assume.

It should be stressed, though, that the forecasts are remarkable for their similarity, not for their differences.

Question

What progress has the Administration made in implementing recently enacted FMS financing reforms?

Response:

The Administration is in the final stages of preparing the regulations necessary to implement the Foreign Military Sales Credit debt refinancing. It is our intent that these regulations will be published on or before March 21st, the 90 day deadline established by law. The actual implementation of the enacted financing reforms will be dependent on commercial financial institutions and the affected countries being able to reach agreements on financial instruments based on the policy guidelines.

Question

What is the Administration's view on the dramatic shift in resource flows occasioned by the shift in oil prices?

Response:

The sharp decline in oil prices since 1985 has had substantial regional impacts. Resources have flowed out of oil-producing states and toward regions which are the heaviest oil consumers. This reverses some of the movement in the opposite direction which occurred in the prior decade. In addition, consumers and energy-intensive businesses have benefited, and this has helped to stimulate personal consumption expenditure and (nonoil related) capital investment.

QUESTIONS SUBMITTED BY SENATOR CHILES

Question

I understand from testimony given by Secretary Bowen of the Department of Health and Human Services yesterday before the House Appropriations Committee that OMB added $150 million to the requested AIDS budget.

-- What areas of the AIDS proposal made by the Department did OMB find inadequate?

Response:

We are encouraged by the progress the Department of Health and Human Services (HHS) has made against AIDS. We were made aware of some new opportunities to pursue AIDS research and prevention and believe that adequate funds should be available to promptly invest when other opportunities arise over the next 20 months. We defer to HHS' scientific judgment on specific programmatic matters. The Secretary's authority to reallocate AIDS funds in FY 1988, and our proposal to consolidate Public Health Service AIDS funds in FY 1989, would enhance HHS' ability to match AIDS resources with the most promising AIDS research and prevention opportunities.

Question

The budget for the Department of Health and Human Services proposes a $68 million cut -- about 20 percent -- in Refugee and Entrant Assistance. The rationale for the cut is that refugees entering this country are projected to decline to 51,000 in fiscal 1989, down from 66,000 in fiscal 1988. Yet the State Department is estimating the admission of 68,500 refugees in fiscal 1989 (page I-Q11 of FY 1989 Budget Appendix).

How did it happen that two different Federal agencies based their budgets on such widely divergent projections of refugee admissions?

Wouldn't the State Department have a better idea about refugee admission policy than the Department of Health and Human Services?

May I have your assurance that you will send up an amended President's budget estimate for refugee and entrant assistance, based on the State Department projection of fiscal 1989 admissions?

Response:

The fundamental difference is based on the State Department's concern with the refugee ceiling and the Department of Health and Human Services' concern with an "expected value" of refugee arrivals. The State Department refugee ceiling is just that -- the maximum number of refugees that may be admitted in the fiscal year. The HHS budget takes into account both the actual number of refugee arrivals and how long they have been in the country.

For example, a refugee arriving in October may get welfare benefits for 12 full months in the fiscal year. That refugee would cost 12 times as much as the refugee arriving in September who may get benefits for only one month. The timing of arrivals matters as much as the total number of arrivals.

We have observed that the actual number of arrivals is always lower than the ceiling, as it should be. In FY 1987, for example, less than 65,000 refugees arrived -- the ceiling was 66,000. Moreover, more than 14,000 -- over one-fifth -- of those refugees arrived in September, at virtually no cost to the Refugee and Entrant Assistance program in FY 1987.

Of course, many other factors affect the Refugee and Entrant Assistane budget request -- not just number and timing of arrivals, but welfare dependency rates, length of time on the welfare rolls, and average cost per case. We will continue to monitor these variables as the year progresses.

Question

Starting this month, and until September 1988, I understand that cash and medical assistance is being limited to refugees who have been in this country less than 24 months, down from the previous 31 months, due to cutbacks imposed by the fiscal 1988 continuing resolution. This cut comes on top of the fiscal 1986 sequester, which reduced the eligibility period from 36 to 31 months.

How much would have to be added to your fiscal 1989 budget request to restore cash and medical assistance to 31 months and 36 months, respectively--based on the State Department's projection of 68,500 admissions?

Response:

There is no simple mathematical model to determine what additional funds would be required to subsidize more refugees for a longer period of time. Several variables influence funding needs for the program. For example, giving States more subsidies causes behavioral shifts -- States lose incentives to make refugees self-sufficient. As a result, refugees may be on the welfare rolls much longer and at greater costs to the Federal government.

Furthermore, as recent history suggests, large numbers of refugees frequently arrive at the end of the year, at virtually no cost to the Refugee and Entrant Assistance program. In fiscal year 1987, for example, over one-fifth of the refugees arrived in September. Moreover, history indicates that the actual number of arrivals is always lower than the refugee ceiling. Assuming that 68,500 refugees enter the country implies a refugee ceiling much higher than that.

However, based on your request, roughly $25-50 million in additional funds would be needed to pay States for 31 months rather than 24 months. Roughly $40-80 million would be needed if States were given subsidies for 36 months rather than 24 months.

In either case, changing the period of full Federal reimbursement does not affect the benefits for which a refugee may be eligible. Adding funding to the Refugee and Entrant Assistance program in this way only gives more money to States.

Question

Mr. Miller, when I look over your budget, I have to question the Administration's commitment to the homeless. In the programs funded by my subcommittee's bill, your budget claims to slightly increase funding for the homeless. But when you look at funding specifically targeted to the homeless by the Stewart McKinney Bill, the total actually drops by almost half ($66 million in FY 88; $38 million in FY 89). The Departments of Education and Labor don't propose any homeless funding.

-- How do you justify this -- have the needs of the homeless somehow lessened this year?

Response:

The Administration's budget does reflect a commitment to the homeless; it contains an increase in funding for homeless activities over the level enacted by Congress in FY 1988. The budget request for the homeless includes:

- $80 million for FEMA's Emergency Food and Shelter Programs to meet emergency needs;
- $77 million for McKinney Act changes in the Food Stamp program;
- $75 million for HUD's Supportive Housing Demonstration that will provide housing for up to

18 months for homeless families and individuals until they can become self-sufficient.

- $50 million of HUD's Section 202 program funds to be used to construct permanent housing for handicapped homeless with special priority given to the mentally ill homeless;

- $36 million for Alcohol, Drug Abuse, and Mental Health Administration (ADAMHA) homeless demonstration projects that are primarily focused on the problems of the homeless chronically mentally ill;

- $26 million for the Runaway and Homeless Youth program;

- $14 million for ADAMHA Homeless Youth program;

- $15 million for Health Resources and Services Administration homeless services grants;

- $13 million for Veterans Administration Chronically Mentally Ill Homeless Veterans Projects (no funding was scored for reprogramming of other funds to provide domiciliary beds for homeless veterans);

- $2.4 million for DOD's homeless assistance efforts; and,

- $1.2 million for the Interagency Council on the Homeless;

This total request is $390 million, an increase of 4.3 percent over what Congress provided in FY 1988 ($374 million) for homeless programs overall.

Question

Dr. Miller, I want you to know many of us are deeply heartened and just a little bit confused by the Administration's request for the Department of Education. You and Secretary Bennett last year appeared before this committee to request a $5.7 billion cut from the previous year's appropriation. This year your request is $850 million above the 1988 appropriation, and $7.2 billion over what you requested just 13 months ago.

What is different this year from last year?

Response:

President Reagan has always been a strong supporter of efforts to improve the quality of education at all levels for all students. As demonstrated by the convening of a national commission to explore the quality of education, which led to publication of A Nation at Risk, the Administration has always understood that a key Federal responsibility is to gather and analyze national data on education, and to point out the areas of weakness and strength so that parents, teachers, schools, local communities and States can take the steps needed to improve education.

Each past budget has provided for the maximum amounts for Education Department programs that were consistent with the budget constraints of that year and our assessment of which programs were most likely to use the funds well. Each budget sought to provide maximum support for programs for the poor and the handicapped within those limits.

The Bipartisan Budget Agreement established the overall boundaries for the 1989 budget. It provides for a 2 percent increase in total for domestic discretionary programs and allows full discretion on the allocations within the totals. Exercising that discretion, and mindful of the President's support of educational improvement, the budget provides more than a 4 percent increase for Education Department discretionary programs.

At the same time, we continue to pursue elimination of funding for education programs which are duplicative of others, are inefficient, or have long since fulfilled their purposes.

In addition, the budget includes support for proposals to improve accountability for program success at the institutions receiving the funds. Enactment of these proposals in compensatory education, vocational education and certain student aid programs will make this increased investment pay greater dividends in the form of higher quality education for all.

Question

Turn Around In College Work-Study

Mr. Miller, last year at this time, the Administration defended its proposal to terminate all funding for College Work-Study aid by pointing out that there was a surplus of jobs available for needy students without the Federal subsidy. This year you are requesting an $11 million increase for College Work-Study to provide an additional 66 thousand jobs.

-- Has the Administration found that all those surplus student jobs disappeared since last year?

Response:

Not at all. The economic expansion, now in its sixty-fourth month, has created 15 million new jobs and contributed to the decline in the unemployment rate to

5.7 percent, the lowest level in nearly a decade. Students working their way through college will continue to find available employment opportnity in the private sector.

What has changed since last year is that there has been a historic drop in the deficit, from $221.2 billion in 1986 to $150.4 billion in 1987, and an agreement has been reached for ensuring continued progress in reducing the deficit. The President's Budget for fiscal year 1989 abides by the limits set by the Bipartisan Budget Agreement for discretionary spending, but seeks to allocate spending to higher priority programs, like education, while reducing funding for ineffective, duplicative, or low priority programs.

The President's budget provides increased funding for the college Work-Study program. However, under a legislative proposal to be submitted shortly, institutions will now be held more accountable for assuring that Federal Work-Study funds result in improved quality of postsecondary education.

Question

Last year while we were all talking about competitiveness, the Administration argued that the termination of all funding for vocational education was necessary to pay for the new dislocated workers program in the Labor Department. This year you are requesting level funding for vocational education in addition to the funding for dislocated workers.

What has changed within the Administration regarding the value placed on funds for vocational education?

Response:

The 1988 proposal to terminate all Federal funding for vocational education was never predicated on the need to pay for a new dislocated workers program in the Labor Department. The 1988 policy reflected the need to meet particularly severe deficit reduction targets and the general dissatisfaction in the employing community and among most serious analysts with the current performance of the vocational education system. Within the constraints under which that budget was formulated, the Administration made a calculated decision that scarce Federal resources would be better invested in other Federal education activities. The 1988 policy in no way proposed an end to vocational education. It recognized that the primary investment in vocational education is and would continue to be a State and local responsibility.

The 1989 budget request was created under a different set of constraints. Deficit reduction targets established in the Bipartisan Budget Agreement permit more funds to be devoted to non-defense discretionary programs such as vocational education. However, concern over the performance of the vocational education system remains. Therefore, an important part of the 1989 budget policy for vocational education is specifically aimed at improving the performance of vocational education students and enhancing accountability for results in vocational training programs which receive Federal financial assistance. These goals would be accomplished through the enactment of the Administration's legislative proposal to strengthen the accountability provisions of the Perkins Act.

In order to achieve real program improvement in vocational education, State and local educational agencies would be held accountable for meeting the goals of individual programs. States would have to develop standards of basic academic skill development and job placement in addition to occupational competency attainment, measure local performance against those standards and use the results in approving local applications for Federal funds. With such requirements in place, continued Federal investment in vocational education is justified.

Question

Dr. Miller, I note in your budget that you take pains to acknowledge that cuts in Medicaid would probably not be considered kosher under the summit agreement. We exempted low-income entitlement programs, and you agreed. I support that is why your budget does not repeat this year one of your favorite proposals to put a permanent cap on federal Medicaid payments to states.

But, I was just a little surprised to see a cut of 400 million in 1989, growing to a total of 3 billion dollars over five years. All this is to come from regulatory action -- you didn't propose legislation.

I'm not going to make a judgement on each of the regulatory proposals, Maybe some of them are right and good.

But I can anticipate that we will hear some dissent around these corridors. Maybe only from certain states, but we will hear.

I can already see us dealing with legislation to block or delay some new Medicaid regulations. When that happens, I guess OMB will want to score that legislation as a spender. If we want to stop some of these Medicaid regulations, we will have to be looking for other areas to cut to make up for it. Otherwise we'll be accused of increasing the deficit. Isn't that the case?

Response:

The Bipartisan Budget Agreement established the legislative framework for entitlement programs in FY 1989. The regulatory initiatives proposed for FY 1989 are simply part of the ongoing job of fine tuning the system. Last year we implemented regulatory changes for FY 1988 with similar budgetary impact and likewise in the year before that.

The initiatives can be divided into two groups. About three-fourths of the savings, or $312 million, result from clarifications of current policies. Changes are needed to clarify ambiguities in definitions or to respond to changes in State practices. Certain States have obtained Federal funds in ways technically permitted under the law but which have been judged to conflict with the intent of the law. Responding to changing circumstances is simply a normal part of the operation of the complex, dynamic Medicaid program. Savings of $101 million are accomplished by providing guidance and encouragement to the States to adopt practices currently authorized in the statute.

Under current law, the Department of Health and Human Services, through its regulatory powers, has the responsibility of managing day-to-day operation of the Medicaid program within the scope of its statutory authority. Spending projections take into account the effect of departmental policy decisions. Therefore, legislation which would vacate specific departmental policies already in motion will effect projections of Federal expenditures.

Question

The Administration is requesting a $112.4 million contingency fund to implement the Catastrophic Health Insurance Program, if it is enacted by Congress this year. How will these funds be used? How much of these funds will be considered one-time only start up-costs? How much of these funds will be dedicated to beneficiary education? How will the beneficiaries know what is and what is not covered by the plan? Do you have any estimates as to what the annual costs of administering the Catastrophic Health Program will be?

Response:

HHS advised us that the $112.4 million requested is the current estimate of the costs of implementing the Senate catastrophic health insurance bill. Of this amount, $67.4 million is for start-up costs and the remaining $45 million is for ongoing operations.

The actual implementation costs will depend on the final substantive language enacted by Congress. Our current planning calls for:

- Medicare contractors as "carriers of record" and handling all claims for beneficiaries in their service areas while the Health Care Financing Adminstration will coordinate the transmission of payment data among contractors.
- Approximately 40 percent of the funds will be used for implementation and ongoing operations of a computer system to keep track of Medicare expenditures incurred by beneficiaries so that we can accurately determine when they have met the "out of pocket" expense cap.
- Funds will also be used to carry out an extensive beneficiary awareness program on the risks, costs and availability of protection for catastrophic illness expenses. In addition, we plan to have a major mailing to all Medicare beneficiaries explaining the new program as soon as possible after enactment.
- The remaining funds will be used for developing a process to administer the drug coverage benefit. We still have a number of questions to resolve in this area such as how to keep track of the annual deductible and how to hook-up with the 65-67,000 pharmacies in the U.S.

Until the final details of the legislation are known, it is difficult to estimate the ongoing annual costs of implementing the bill. In particular, the cost of adminstering the drug benefit will depend on whether or not coverage is phased in over time. We will examine these questions more thoroughly as we develop the FY 1990 budget.

QUESTIONS SUBMITTED BY SENATOR BURDICK

Questions

Director Miller, I understand that your budget for fiscal year 1989 includes asset sales under the Farmers Home Administration and the Rural Electrification Administration totalling several billion dollars. The receipts generated by these sales for fiscal year 1989 are supposed to equal two and one-half billion dollars. You can correct me if I'm wrong, but I assume that these receipts are figured into your budget calculations. My understanding of the Gramm-Rudman-Hollings bill says that these asset sales are not to be used to provide Government savings.

How have you used asset sales in this budget?

Response:

The FY 1989 budget includes gross proceeds from the sale and prepayment of loans that total $8.5 billion. Of that amount, GRH allows $2.1 billion to be counted towards reducing the deficit. The balance consists of proceeds from loan sales and prepayments proposed by the President for the coming fiscal year.

Question:

What is the total face value of asset sales contemplated by this budget for each agency? What is the return estimated for each of these agencies?

Response:

The budget proposes the sale or prepayment of loans in FY 1989 that have a face value of $12.0 billion, which are estimated to produce $8.5 billion in gross proceeds. The breakdown by agency is shown in the following table:

LOAN ASSET SALES AND PREPAYMENTS IN FY 1989
(millions of dollars)

	Face value	Gross proceeds
I. In GRH Baseline		
SALES:		
VA	1,341	781
RDIF	1,125	630
Subtotal, sales	2,466	1,411
PREPAYMENTS:		
Eximbank prepayments	525	525
Railroad rehabilitation	165	120
Subtotal, prepayments	690	645
Subtotal, in baseline	3,156	2,056
II. Not in GRH Baseline		
SALES:		
RHIF	1,752	870
REA direct loans	1,600	972
College hsg & acad facilities.	483	230
HHS medical facilities	122	76
FHA fund	146	100
SBA	1,080	710
Subtotal, sales	5,183	2,958
PREPAYMENTS:		
FMS prepayments	2,300	2,300
REA (FFB) prepayments	1,000	1,000
REA direct loan prepayments	250	152
RTB prepayments	50	50
HHS health maint orgs	30	20
Subtotal, prepayments	3,630	3,522
Subtotal, not in base	8,813	6,480
III. Totals		
Total, all sales	7,649	4,369
Total, all prepayments	4,320	4,167
Grand total, all sales and prepayments	11,969	8,536

Question:

Isn't it true, that while these savings are short-term, in the long-term there is an expense because assets are being sold at a discount?

Response:

When loans are sold, we trade the future stream of repayments and interest for the upfront, or present, value of those streams. That present value is determined by investors who apply current, market rates of interest to the future stream of cash flows of Federal loans. There is no economic loss involved in this transaction since the market value of the loans -- the amount we receive for them -- is by definition their real value.

In exchange for receiving the present value of the loans, the Federal Government gives up the principal and interest that would have been collected in the future; therefore, in a cash accounting sense, future deficits will be larger than they would have been had the loans not been sold or prepaid. However, those larger deficits are partly offset by lower debt servicing costs that result from increased proceeds that reduce the deficit in the year of sale.

Question:

Isn't it also true that we are now having to pay for that discount in terms of reimbursements to the funds involved, for example, the rural housing insurance fund and the rural development insurance fund?

Response:

The two funds mentioned have the authority to seek reimbursements for prior year losses. One component of losses is write-offs for direct loans. When loans are sold, the difference between the face value of the loans and what is received upon sale is written off in the program's loan portfolio. Since reimbursement is sought two years after the transaction that generates the loss, the FY 1989 appropriation for prior year losses includes requests to cover the losses incurred from the sale of rural housing and rural development loans in FY 1987.

Question

Dr. Miller, under the International Affairs function, the discretionary funding was to increase by two percent. Nevertheless, your budget requests a $73 million reduction in the program level for P.L. 480 and a $36 million reduction in the appropriation for this program.

In complying with the summit agreement, could you please explain what programs under this function received increases, describing specifically, for what the increases will be used.

Will any of these increases go for military assistance, and, if so, how much?

Response:

The President's proposed budget for function 150 does seek to redress some of the damage done to U.S. security and foreign policy interests caused by deep cuts in security assistance over the last few years. Nonetheless, the President's proposal does so within the limits of the Bipartisan Budget Agreement and without forcing any single non-security assistance program to bear a disproportionate cost.

The President's request for a slightly lower amount of P.L. 480 assistance (a 1989 obligation level of $1.4 billion) reflects:

(1) significant reductions in stocks of dairy, rice, and wheat held by the Commodity Credit Corporation, hence less availability for P.L. 480 programs.

(2) higher market prices for wheat, corn, and rice, hence less need for heavily subsidized P.L. 480 loans.

(3) stronger commercial export markets for U.S. commodities (up 30 percent in volume since FY '86 in the last year); and

(4) rising farmer incomes as a whole.

All of these factors reduce the need for an increase in the P.L. 480 program.

Question

Dr. Miller, it has come to my attention that in allocating the funds under the Rural Electrification Administration Programs, the Office of Management and Budget sets up a quarterly allocation.

Is this true? A quarterly allocation has the effect of slowing up loan disbursements.

Under what authority do you issue such an allocation?

When was this quarterly allocation practice instituted?

Have you divided up the allocations for fiscal year 1988 for each of the funds including the Rural Telephone Bank? If so, please list those allocations.

Response:

All budgetary resources that involve an obligation of funds fall under review for apportionment purposes. Appropriated loan levels are also subject to apportionment. A slowdown in disbursements is not necessarily caused by an apportionment of loan approvals. Loan disbursements from approved loans are spent over a relatively long time period for Rural Electrification Administration program loans.

Appropriated loan levels are subject to quarterly apportionment as required under the Antideficiency Act. As you know, each budgetary resource is subject to apportionment so that obligations will not exceed appropriated levels and so that departments or agencies do not obligate an entire fiscal year appropriation in the first few months of the year and then ask Congress for more appropriations.

The first version of the Antideficiency Act was enacted by Congress and approved by the President on July 12, 1870, and in 1905, the Act was amended to include the "obligations". Clearly, loan originations are obligations of the Federal government.

The quarterly allocation is somewhat modified due to the short term Continuing Resolution in the first quarter. Per your request, the allocations are as follows:

<table>
<tr><th></th><th></th><th>Quarter One</th><th>Quarter Two</th><th>Quarter Three</th><th>Quarter Four</th></tr>
<tr><td>Guaranteed loans</td><td></td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>Floor</td><td>933,075</td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>Ceiling</td><td>2,100,615</td><td colspan="2">95,000</td><td>85,000</td><td>753,075</td></tr>
<tr><td>Direct loans, electric program</td><td></td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>Floor</td><td>622,050</td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>Ceiling</td><td>933,075</td><td colspan="2">343,643</td><td>185,000</td><td>93,407</td></tr>
<tr><td>Direct loans, telephone program</td><td></td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>Floor</td><td>239,250</td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>Ceiling</td><td>311,025</td><td colspan="2">110,000</td><td>55,000</td><td>74,250</td></tr>
<tr><td>Rural Telephone Bank</td><td></td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>Floor</td><td>177,045</td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>Ceiling</td><td>210,540</td><td colspan="2">60,000</td><td>40,000</td><td>77,045</td></tr>
</table>

QUESTIONS SUBMITTED BY SENATOR LAUTENBERG

Question

Superfund Technical Assistance Grants

You've had the regulation for the Superfund Citizen Grants program sitting at OMB since about February 2 of this year.

Why isn't OMB complying with a directive in the 1988 Appropriations measure, which called for publishing that regulation by February 5?

Response:

The language in the Senate Appropriations report, which called for publishing the Technical Assistance Grants regulation by February 5, was not adopted in conference and is not binding. Furthermore, since the regulation was received at OMB on February 2, publishing by February 5 would have precluded even the most cursory E.O. 12291 review.

Question by Senator Lautenberg:

Why didn't OMB complete its review of the regulation by February 10, as was originally planned?

Response:

OMB is unaware of any plan to complete its review of the regulation by February 10.

Question by Senator Lautenberg:

When will you have the regulation back to EPA?

Response:

OMB is discussing this regulation with EPA. It is not possible to predict when the discussions will end, but agreement in concept has been reached on the major issues.

Question by Senator Lautenberg:

Congressional intent is for the regulation to provide a flexible, straightforward, and unburdensome process for grant applicants.

Is OMB complying with that intent?

What changes, if any, is OMB contemplating making to EPA's proposed regulation?

Response:

OMB agrees that this regulation needs to provide a flexible, straightforward, and unburdensome process for grant applicants, and is working with EPA to ensure this.

Question

Why is the President sending us the same old Construction Grants package for FY '89 that led to the overwhelming veto override last year?

Response:

The President is standing up for what he believes is right. Congress wrongly framed the debate over authorization of the Clean Water Act as an issue of clean water versus dirty water. The President took a lot of heat from Congress and the press for vetoing the Clean Water bill passed by Congress. He was accused of being anti-environment despite the fact that his main concerns centered on funding levels for what is largely a massive public works program -- the construction grants program. Nevertheless, when presented by Congress with the identical bill several months later, the President vetoed it again and faced the same accusations.

This should never have been a Federal program, and $12 billion through 1993 that he recommended is the maximum that we should spend to complete the transition to State/local responsibility. Besides providing a lengthy transition period, the $12 billion program will provide the "federal share" to complete all projects already begun with federal funds and to bring existing plants into compliance with secondary treatment requirements.

Although the President's vetoes were overridden, we will continue to do what we can through the appropriations process to hold down wasteful spending for the construction grants program.

Question

What does the budget message mean when it calls for privatizing sewage construction? How much of New Jersey's $3.5 billion in sewage-construction needs and of the nation's $76 billion in needs can be financed through so-called privatization?

Response:

In the area of privatization, EPA has set up a new office to encourage privatization to the extent appropriate and consistent with applicable statutes. Private construction, operation, and maintenance of sewage treatment plants often can be more cost-effective, and we want to better inform State and local governments of privatization success stories and how they were achieved. Individual municipalities in New Jersey and other states, however, must ultimately decide whether privatization is the best strategy for their particular situations.

QUESTIONS SUBMITTED BY SENATOR HARKIN

Question

Mr. Miller, section 136 of the District of Columbia Appropriations Act of 1988, Public Law 100-202, requires that the President "include" in his annual budget submission the amount estimated by the Mayor of the District of Columbia to be required for water and water services and sanitary sewer services furnished to facilities of the United States Government under the District of Columbia Public Works Act of 1954, as amended. The President's budget as submitted on February 18, 1988 does not include the required request. Why wasn't the required estimate included and how does this action comply with the statute?

Response:

Section 136 simply requires the President to include, without change, the values estimated by the Mayor for water and sewer services furnished to Federal establishments. The President's budget shows the Mayor's 1989 estimate of $36.7 million for these services in bold italicized print. Unlike the Congress' actions during the 1988 appropriations process, the President's 1989 budget does not request funding for water and sewer payments twice (i.e., in the Federal payment to the District account and in the individual Federal agency budgets). The individual Federal Agency budgets contain funds for 1989 water and sewer payments.

The 1988 Continuing Resolution (CR) increased the deficit unnecessarily by adding-on $32.6 million to the Federal payment when many Federal agencies already had sufficient funds to pay the District directly. For example, the Department of Defense and the General Services Administration together had about $30 million to pay the District for water and sewer services at the time Congress passed the CR last December.

Responding to Congress' concerns about the District's authority to bill Federal establishments directly, the budget also contains language that specifically authorizes the District to bill Federal agencies.

Question

Why does the Administration request a change in the law in the Treasury-Postal Service bill and not in the District of Columbia portion? Why isn't separate authorizing language requested?

Response:

The requested change was made in the Treasury-Postal Service bill because it contains most of the government-wide type of general provisions that apply to most Federal agencies. The provision directs and authorizes Federal agencies to make payments from their budgets to the District government.

The budget also requests separate authorizing legislation in the District of Columbia portion--similarly authorizing the District to bill Federal agencies directly for water and sewer services.

QUESTIONS SUBMITTED BY SENATOR HATFIELD

Question

The President and the Congress agreed in the budget summit agreement last fall that the President would not request, and the Congress would not consider, any supplementals except for "dire emergencies." It is my understanding that you will transmit a supplemental request in the near future and the request will be deficit neutral. I have several questions about the impending request.

First, how do you propose to achieve deficit neutrality?

Response:

The agreement on discretionary spending specifies that there are to be no supplemental funding increases except for dire emergencies. For the Executive Branch, requests will either involve language that does not affect budget authority or outlays, or requests for funding that are met by offsetting the budget authority and outlays needed through transferring or reprogramming resources from lower priority areas.

Question

Second, can you identify the accounts for which you will be seeking supplementals?

Response:

Attachment A summarizes the language supplementals for the Executive Branch discretionary programs that are expected to be transmitted soon.

Requests for the Judicial Branch

The Judiciary has submitted requests totalling $57 million to fund the cost of the January 1, 1988, Federal pay raise and other purposes. We have advised the Judiciary that these requests do not appear to meet the budget agreement criteria for supplemental requests, but they have asked that these requests be transmitted anyway. By law, budget requests from the Judicial branch are transmitted without review or change.

Supplementals for mandatory programs outside the discretionary spending agreement

The budget agreement proposed legislative initiatives to cover spending programs not under the discretionary agreement. These legislative initiatives were either incorporated in last year's reconciliation bill or are proposed in the FY 1989 budget. Legislative actions fall outside the jurisdiction of the Appropriations Committee.

In a few cases -- mainly for the Veterans Administration -- reestimates of mandatory spending programs have occurred that entail $1 billion of additional funding. These supplementals for mandatory programs are summarized in attachment B. The additional funding requires the approval of the Appropriations Committees. As the requests are not covered by the agreement on discretionary spending and new legislative initiatives proposing to reduce mandatory spending would break the deal, no offsets have been proposed.

Question

Third, how have you defined "dire emergency" for the purpose of making these requests? Is it a matter of avoiding program terminations and personnel reductions, or a matter of boosting Presidential policy priorities?

Response:

The budget agreement did not define what is meant by dire emergencies. Since none of the discretionary requests mentioned involve supplemental funding increases -- except for the Judiciary requests that we do not control -- the definition of dire emergency is not applicable. Our criteria will generally look at questions of human safety and protection of property --

examples might be natural disasters or the need to correct an immediate public health problem -- but this is something that we will be working out with the Congress over the coming months as specific circumstances arise.

Question

Finally, why didn't you transmit this supplemental request with the budget so that the tables and budget totals in that document would reflect the additional FY88 request?

Response:

As your questions suggest, there is some confusion about the agreement reached on the treatment of supplementals. To avoid any implication that the budget violated the deal because of supplementals even though the requests involved are consistent with the deal, we decided to send them up in a separate package.

Attachment A

FY 1988 Language Package

	(In millions of dollars)	
	BA	Outlays
The Judiciary	57	50
Executive Branch Requests Under the Discretionary Agreement		
Department of Commerce		
Bureau of the Census	---	---
Department of Defense		
General provision language	Authority to transfer up to $4 billion, between DOD accounts.	---
Department of Justice	1/ Transfer of $64 million	---
Department of Labor		
Training and employment services	---	---
Department of Transportation		
Urban Mass Transit Administration	---	---
United States Coast Guard	Transfer of $60 million	---
Maritime Administration	---	---
National Aeronautics and Space Administration		
Research and program management	Transfer of $42 million	---
Small Business Administration		
Salaries and expenses	$13 million transfer from BLIF	---
Business loan and investment fund (BLIF)	---	---
Veterans Administration		
General operating expenses	---	---
Board for International Broadcasting		
Grants and expenses	---	2/ 20

1/ Included in this request are FY 1989 amended budget requests totaling $125.1 million in BA and $75.7 million in outlays.

2/ This is offset by a $20 outlay reduction in FY 1989. This does not violate the Bipartisan Budget Agreement outlay ceiling because total outlays for FY 1988 for function 150 (international programs) remain below the ceiling.

ATTACHMENT B

Supplements for Mandatory Programs Outside the Discretionary Agreement

Department of Labor		
Black lung benefit payments................	(Transfer of $54 million)	54
Veterans Administration		
Compensation..............................	480	406
Pensions..................................	13	13
Burial benefits and miscellaneous assistance..............................	5	5
Readjustment Benefits.....................	25	23
Loan guaranty revolving fund..............	527	480
Total.................................	**1,050**	**981**

Question

Defense Spending

This administration has presided over the largest peace time defense buildup in history. We have spent huge sums on exotic weapons, but I question whether we are more secure today than we were seven years, and more than a trillion dollars, ago. The Washington Post reported on Monday that our conventional forces consistently lose in war games with "Soviet" troops.

How do the defense priorities in this budget ensure that we can reverse this outcome?

Response:

The Washington Post article is misleading. The purpose of the National Training Center (Ft. Irwin) is not to keep "won/lost" scores, but to deliberately create a difficult training situation so the troops involved can learn from their mistakes. It is analogous to making a "scrimmage" more difficult than the actual "game."

The "Russians" at Ft. Irwin are experienced, permanently assigned troops who know every inch of the terrain they fight over repeatedly. They are probably much more difficult opponents than the real Russians we could expect to encounter on a European battlefield.

The Mojave desert, with its open spaces and sparse sagebrush vegetation is much more difficult country to defend against an armored assault than the partially forested, semi-urban plains of central Europe. A weapon such as Dragon (for instance) is much more effective in hilly or urban terrain than in open desert, where the primary anti-tank weapon is the much longer range TOW missile (not mentioned in the Post article).

In short, the Ft. Irwin experience is designed deliberately to be (except for actual lethal danger) tougher and more demanding than the actual combat situation the troops might face. The Army believes this is the best way to ensure that our forces win in the "real" war.

Question

Mass Transit Funding

One of the nation's most successful mass transit programs opened a year ago in Portland, Oregon. The MAX system was completed on-time and on-budget. Ridership on MAX has far exceeded all expectations and there is a need to expand the system to the west side of Portland.

Given a 54 percent reduction in mass transit funding requests, will there be funding for the expansion of mass transit programs for which local matching funds are assured? How can these programs be funded in the outyears if they are cut so drastically now?

Response:

The level we are proposing for 1989 is adequate to support the Federal role in mass transit. Transit serves local needs and is best funded at the local level. Distributing the Mass Transit Account of the Highway Trust Fund by formula will provide states and localities with an equitable and stable source of funding. It is inequitable to continue subsidizing the projects of less than 20 cities by fuel taxes paid throughout the country. Much of the reduction could be compensated by increased State and local financial assistance, efficiencies in competitive contracting, increased productivity, and better management of capital equipment. While states and cities have increased the amount spent for transit in recent years, they continue to spend less than 2 percent of their combined budgets on transit. Each "new start" funding recipient has been aware of our intent over the last few years to discontinue discretionary funds. New start grantees are also aware that all of the Department of Transportation's full funding contracts require them either to complete projects with local funds or not to begin projects if future Federal appropriations would be required for completion.

Regarding expansion of current transit systems, Federal funds will be available for capital projects under our proposal but only through a formula program. A look at recently completed systems shows that pre-construction forecasts of ridership are rarely met when systems are placed in operation, while capital, operating, and maintenance costs invariably are higher than originally projected. Even the Congressional Budget Office concluded that "new construction of rail systems is rarely cost effective in improving urban mobility or reducing congestion."

While the Portland system experience to date has been better than the situations in Buffalo and Miami, for example, it too has failed to meet the forecasts used to make the decision to build the project. MAX was projected to have 43,000 riders by 1990, just two years away, but current ridership is only 19,000 and has actually decreased since the system first opened. Even more striking is the fact that only about 33 percent of the 19,000 daily riders were formerly auto users. The majority of others were already using Portland's extensive bus system. This means that almost one quarter of a billion dollars was spent to remove some 3,000 vehicles from Portland's highways on a typical day, an almost negligible number in a region of one million people.

The Administration believes that since system expansion should benefit a local area, the local area should foot the bill. This policy is echoed in the recently published report by the National Council on Public Works Improvement.

Question

Because the NASA budget increase would consume nearly 60 percent of the increase for all domestic non-entitlement programs, there seems to be little money left for the neediest Americans. For example, the budget proposes a 40 percent real reduction in the Housing Assistance Program for the Elderly and Handicapped, and a 25 percent real reduction for the Low Income Energy Assistance Program.

How does the Administration propose to fund the space station and the super collider in the outyears and not continue to reduce funding for programs like those listed above?

Response:

Decisions on each of these programs (for both the budget year and the outyears) are based on the merit of the program, and the appropriateness of Federal support (particularly in light of the role of States and localities). However, your assertions of large real decreases are somewhat overstated.

For example, while the FY 1989 loan limit for Section 202 Housing for the Elderly and Handicapped would decrease, the Administration's subsidized housing proposals would actually increase the number of people served through housing vouchers. Furthermore, overall subsidized housing outlays would increase from $11.0 billion in 1988 to $12.4 billion in 1989, a 13.2 percent increase. This latter figure is $7.9 billion higher than the 1980 outlay level of $4.5 billion.

The Administration favors housing vouchers over new construction generally because they are more efficient. The Department of Housing and Urban Development's FY 1989 request would subsidize an additional 108,000 households: 100,000 with vouchers and 7,000 through Section 202. In addition, the Farmers Home Administration (FmHA) would subsidize another 27,500 for a grand total of 135,500 (HUD and FmHA). These additional households represent an 8 percent increase over what Congress provided in FY 1988. The FY 1989 proposed level would be continued in the outyears.

Similarly, the FY 1989 request for the Low Income Energy Assistance Program is only $50 million less than the level approved by the Senate for FY 1988. No additional reductions were included in the outyear estimates. In addition to the hundreds of millions of dollars States have available from oil overcharge settlements, stabilizing and decreasing fuel prices have enabled many of the entitlement programs to "catch up" with heating prices.

Question

Crime Prevention/Prisons

The budget calls for increased law enforcement for several agencies. No one is opposed to greater law enforcement of the laws we pass, but I must question the wisdom of doubling the amount of money to build new prisons while we are cutting programs for long-range crime prevention. If we continue to neglect the poor, we are ensuring the need for more jail space.

What is proposed for programs which attack the root causes of crime: child abuse, hunger, illiteracy, poor housing and drug dependency?

Response:

The FY 1989 budget includes $29.6 million for child abuse prevention programs in the Office of Human Development Services. These funds support grants to States to improve and increase child abuse prevention and treatment activities. FY 1989 funds will also support continued research into the causes and effects of child abuse and neglect.

The President proposes $1,036 million for drug abuse education, prevention and treatment in FY 1989, an increase of $112 million over the FY88 level of $924 million.

The FY 1989 budget proposes to:

- increase funding to States through the Alcohol, Drug Abuse and Mental Health Block Grant from $487 million in FY 1988 to $509 million in FY 1989;

- establish a $40 million grant to States for the treatment of intravenous drug abusers to prevent the spread of AIDS;

- increase funding for Substance Abuse Grants for State and local drug treatment programs from $156 million in FY 1988 to $166 million in FY 1989;

- increase drug education funding to States and educational institutions from $230 million in FY88 and $250 million in FY 1989, the maximum authorized under current law; and o treat all veterans with drug dependence who are expected to apply for care.

The President's budget also requests $20.7 billion in FY 1989 to maintain food assistance programs at current service levels. Administration proposals will focus on improving program integrity, and ensuring efficient and effective use of Federal meal subsidies.

The President's budget for 1989, as it did in 1988, places high priority on the support of programs to combat illiteracy among the nation's adults.

In particular, the 1989 budget proposes to increase spending on local programs funded under through State formula grants under the Adult Education Act from the 1988 level of $115.4 million to $148.0 million. The funding level proposed in the 1989 budget would be the highest funding level ever for this program and would represent more than a 50 percent increase over the program's funding level in fiscal year 1986, just three years ago.

In addition to this substantial funding increase for adult education, the Education Department will continue its efforts to promote government-wide coordination of activities that promote adult literacy as well as private sector and volunteer participation in literacy programs. These efforts have included a survey of Federal adult literacy activities to identify resources for literacy programs; promotion, in coordination with the Council for State Planning Agencies, of a State Policy Academy on Adult Literacy in ten States; a project to facilitate the transfer of basic skills education technology developed by the Army to the public and private sectors.

The budget also increases support for programs that are designed to enhance the educational performance of children whose current educational deprivation, if untreated, can produce adults who will not be able to cope in modern society. Toward this end, the 1989 budget proposes to increase funding for the programs currently funded under Chapter 1 of the Education Consolidation and Improvement Act from $4.3 billion in 1988 to $4.6 billion in 1989. The 1989 budget also provides increases for bilingual, immigrant and refugee education programs (5 percent over 1988) and for Indian education programs (2 percent over 1988).

The FY 1989 budget proposes funding for an additional 135,500 housing subsidies: 108,000 through HUD and 27,500 through FmHA. Since 1980, the Administration has added 1.1 million HUD subsidized units and 300,000 FmHA subsidized units to bring the inventory of subsidized housing units in FY 1987 to 5.6

million units. With program additions in FY 1988 and FY 1989, the total number of subsidized households will increase to 5.8 million units.

In addition, the 1989 President's budget reflect continued increases in outlays for subsidized housing -- $11.0 billion in 1988 to $12.4 billion in 1989, a 13.2 percent increase. Indeed, the 1989 level is $7.9 billion higher than the 1980 outlay level of $4.5 billion.

Question

As you know, I have opposed efforts to alter the formula for sharing receipts from the federal Oregon and California railroad (O&C) timber lands in Western Oregon.

- o Does this budget propose to alter the current formula?
- o If so, what are the estimates of revenue loss to the counties which rely on O&C receipts?
- o Is OMB proposing a change in the schedule for existing receipt payment programs? Please explain any proposed changes.

Response:

The budget does not propose to alter the current formula for sharing receipts from the Oregon and California railroad timber lands in western Oregon because that would be outside the budget agreement reached by the Congress and the President for fiscal years 1988 and 1989. Budget projections for fiscal years 1990 through 1993 do presume that receipt sharing will be based on sharing net revenues after deducting Federal costs associated with generation of the gross revenues.

The following are estimates of the effect on revenue shared with the counties:

	1989	1990	1991	1992	1993
Gross Receipts	142.8	130.8	130.8	130.8	130.8
Costs	57.0	57.0	57.0	57.0	57.0
County share of gross	71.4	65.4	65.4	65.4	65.4
County share of net	---	36.9	36.9	36.9	36.9
Gross - Net	---	-28.5	-28.5	-28.5	-28.5

Question

Bonneville Power Administration (BPA) Third A.C. Intertie Transmission LINE

1. Mr. Director, could you please tell the Committee what day next week you expect to transmit the budget amendment restoring nearly $124 million in BPA borrowing authority for the third AC intertie?

As well, could you notify the Committe in writing of your plans to apportion to BPA nearly $22.5 million in FY88 current year borrowing authority which I understand has been temporarily delayed?

Response:

The President's budget included the following statement about this project: "The budget does not include funds for possible Bonneville Power Administration construction of a major new west coast power line. A final decision on funding will be made later this year, after completion of a study of possible non-Federal participation in, and funding for, the project." (The Budget for Fiscal Year 1989, page 5-40.)

The non-Federal participation study is being done in response to a request made by a number of Members of Congress. They, in turn, were responding to interest expressed to them by non-Federal utilities in the Pacific Northwest.

If you will permit me, I believe it is useful to provide some background for the record about interest in non-Federal participation in the project. Most of the project will be in California and will be funded entirely by non-Federal utilities. The rest of the project will be in Oregon. The current budget question is whether there should also be non-Federal participation in, and funding for, the Oregon segment.

In May 1987, a representative of four non-Federal utilities serving 1.2 million customers in the Pacific Northwest said in Congressional testimony, "When the Federal power marketing agencies issued a request in the Federal Register in 1984 for statements of interest in the addition of a new Third 500 kv AC Line to the Pacific Northwest-Pacific Southwest Intertie, we responded indicating our strong interest in securing capacity in the Third 500 kv AC Line. We have continued since that time to indicate our interest in participating on a firm capacity basis in that project but have not yet been included. To us, it appears unnecessary that Federal funds even be expended for this project, in light of the number of utilities which would be willing to finance portions of the project in return for firm capacity. It is not too late for our Companies to be allowed to participate in the new Third AC Line yet it is becoming clear to us that Bonneville has no intention of doing so and, instead, wishes to restrict the use of that facility in such a way as to maximize its own marketing efforts free from the competition of other Northwest utilities." (Statement of John W. Ellis before the House Interior Committee's Subcommittee on Water and Power Resources, May 7, 1987.)

A number of Members of Congress wrote to Bonneville in June 1987 saying, "A number of utilities in both the Pacific Northwest and California have sought support in Congress for some form of participation in the northern portion of the Third AC Intertie." They asked Bonneville to study non-Federal participation alternatives and to report back to Congress before proceeding. (This request was made by Congressmen George Miller, Vic Fazio, Norm Dicks, Les AuCoin, Carlos Moorhead, Al Swift, Peter DeFazio, Ron Wyden, Tom Foley, Larry Craig, Rod Chandler, Don Bonker, Richard Stallings, and John Miller.)

In an interim response sent to Congress in August 1987, Bonneville listed 11 non-Federal utilities in the Pacific Northwest "that have either indicated interest or that we believe may be interested in becoming participants." A final report is to be sent to Congress in late March or April 1988. BPA staff have told us that this report will not make a recommendation, but rather it would identify participation options and provide an analysis of each option. BPA staff expect to make a participation recommendation later this year, after providing for public review and receiving public comments.

Currently, the President's Budget excludes Bonneville Power Administration funding for the project. The decision to exclude Federal funding is made without prejudice to the non-Federal participation study or to the ultimate funding decision. The Administration still supports the overall project, although we must acknowledge that it is premature to decide the level of Federal and/or non-Federal participation and funding.

Question

2. In all seriousness, Mr. Director, the withholding of FY88 and FY89 borrowing authority raises two very sticky issues which I would like to discuss for just a moment.

The first issue is the generic issue. That is what is the means by which BPA's annual budget is prepared and how much flexibility should OMB have to tinker in that process.

The second issue is the intertie itself.

3. Regarding the first issue of OMB's tinkering with BPA's borrowing authority, I would like to remind everyone that BPA operates on borrowing authority which is fully repaid, with interest, to the U.S. Treasury from the regional ratebase.

BPA does not operate off of appropriated funds.

What few people do not realize , however, and which I would like to bring to your attention, Mr. Director, is a series of Memoranda exchanged between OMB and the Interior in 1974 at the time BPA's Self Financing Legislation was enacted.

Are you familiar with this legislative history, Mr. Miller?

I will provide for your information, and for the Committee records, the precise agreement which was reached between OMB and Interior at the time BPA went on a self financing basis. (see attachments)

It was of such paramount importance for BPA to "assure the flexibility and capability to deliver electrical transmission on a timely and reliable basis" that customers of the Pacific Northwest agreed "to assume higher (interest rate) costs" for that flexibility.

This is very clearly spelled out in correspondence between then-OMB Associate Director Frank G. Zarb and Under Secretary of the Interior John C. Whitaker.

In his opening paragraph to Under Secretary Whitaker, Mr. Zarb confirms, and I quote, "...regional interests in the Pacific Northwest are prepared to assume the higher costs associated with the form of financing...in exchange for the assurance that BPA would be given the flexibility and capability to provide transmission facilities on a timely and reliable basis."

Mr. Miller, I am very concerned that OMB's actions violated this very important and fundamental agreement which has stood now for almost 15 years.

GAO in one of their many audits has indicated that BPA may be the only federally chartered entity that pays the U.S. Treasury, more than the prevailing interest rate for its borrowing authority...and it all stems back to this agreement between OMB and Interior in 1974.

I guess that is a long history, Mr. Miller, and my question is more in the form of a request....would you please review this legislative history of which OMB was a major part and, when you submit your amended budget request next week on this matter, state that this continues to be the understanding of the current administration?

I thank you for your attention to that historical matter.

Response:

The budget process used for this project is the same budget process which has been used routinely for the Bonneville Power Administration Fund since that fund was authorized in 1974. The Bonneville Power Administration, like other Executive Branch agencies, makes budget proposals which are reviewed during development of the President's budget. The final BPA budget is then submitted to Congress as part of the President's budget.

Under the 1974 legislation, Congress simplified the Congressional review and appropriations process for the Bonneville Power Administration Fund. Under the simplified Congressional process, Congress does not provide annual appropriations for Bonneville. Instead, permanent appropriations become available up to the amounts included in the annual budget submitted to Congress, but "within such specific directives or limitations as may be included in appropriations acts" (Section 11(b) of the Transmission Act, 1974).

Concerning your point about interest rates on BPA's debt owed to the Treasury, you are correct in pointing out that Bonneville does pay interest rates that are slightly higher than Treasury interest rates for the bonded indebtedness. The interest rate is set by the Secretary of the Treasury "to provide for a rate comparable to the rates prevailing in the market for similar bonds" (Section 13(a) of Transmission Act, 1974). This approach was used for setting the interest rates on the $1.8 billion of bonds sold to the Treasury. However, this approach was not used for $7.2 billion of investment financed previously by appropriations, where much of the investment was financed at interest rates of 3-4 percent.

Question

4. The second matter involves the intertie itself.

Are you aware, Mr. Director, that BPA already is preparing an options paper to be completed this spring regarding intertie access policy, but that an EIS also is being conducted on the construction project itself and that it is assumed by that draft EIS that the line will be 100% Federally owned?

This concurrent process of an intertie options paper, and a separate EIS was the subject of controversial and very delicate negotiations between Members of the House and Senate and representatives of Northern and Southern interests.

Not only will OMB's decision to withhold funding for construction of the intertie require that the EIS process start all over again, but it infringes on some very, very sensitive regional negotiations that have festered for years and which were just agreed to last year.

In order for the construction schedule to be met, the FY88 borrowing authority ($22.5 m) should be restored as quickly as possible, and in order to preserve this delicate agreement OMB should submit a budget amendment restoring the $124 m in FY89 borrowing authority. Otherwise the project will be delayed at least 2 years.

Would you be so kind as to see that this gets done?

Thank you.

Response:

We do not understand why Bonneville's environmental impact statement has only considered 100 percent Federal funding for the project. Bonneville's budget for FY 1987, submitted to Congress in February 1986, included the statement, "If BPA and other Intertie owners are able to make satisfactory arrangements for use of the Intertie by other Northwest utilities through subscription, facilities related to the Third AC line may be funded by non-Federal participants." Moreover, non-Federal utilities in the Pacific Northwest have been seeking to participate in the project for a number of years, and a number of Members of Congress have asked Bonneville to give serious consideration to non-Federal participation.

Question

Privatization of NIH

Mr. Miller, I was glad to see that the much talked about proposal to privatize the National Institutes of Health never made it into the final budget documents for FY89. Of course, once again, OMB stimulated a great deal of concern and uncertainty about the future of NIH funding with the privatization proposal and, once again, Congress is in the position of explaining what is and what is not being requested in the FY89 Budget insofar as the NIH budget is concerned.

Mr. Miller, can we safely assume that the proposal to privatize the NIH is dead? (at least for this year?)

NOTE: The budget documents call for the Institute of Medicine to conduct a study to "evaluate strategies to assure continued scientific excellence of the NIH intramural laboratories."

Response:

HHS is evaluating in preparation for the upcoming NIH reauthorization, strategies to assure the continued scientific excellence of the NIH intramural laboratories. The Institute of Medicine will be asked to undertake a 4-5 month independent study of a range of alternatives, including:

- adjustments to the structure of the intramural research effort based on principles of academic research centers;
- modifying personnel systems to permit an interchange between NIH research, private biotechnology research, and non-profit biomedical research centers;
- continuation of the status quo; and
- other organizational or managerial changes.

HHS has been asked to report its recommendations by June 1, 1988.

Question

Mr. Miller. It is my understanding that the FY 1989 budget request for the agencies and programs within the Department of Health and Human Services includes an additional budget request for FY 1990. I am also told that the budget justifications, which have not yet been forwarded to the Hill, will not include any explanation or justification for the FY 1990 figures.

Why is this advanced appropriation included in this year's budget request?

Has any other Department included such a request?

On what basis is the FY90 number derived?

Response:

The FY 1989 biennial budget request expands a plan started in FY 1988 which requested advance appropriations within the Department of Health and Human Services. The Gramm-Rudman-Hollings bill of September 1987 included a sense-of-the-Congress provision encouraging Congress to experiment with two-year appropriations. Then, in his January 25, 1988, State of the Union Address, President Reagan recommended reform in the federal budget process, citing delays in the enactment of the appropriations bills and passage of omnibus spending bills in lieu of separate appropriations bills as evidence of breakdown in the budget process. A two-year appropriations process would provide sufficient time for legislators to enact appropriations bills in a timely manner, and allow managers to plan for efficient use of a fixed amount of resources.

The Department of Energy and the Department of Transportation both contain accounts for which advance appropriations are included in the FY 1989 budget. Also, the Consumer Product Safety Commission and the National Aeronautics and Space Administration request advance appropriations.

The 1990 request for the Department of Health and Human Services was based on economic assumptions included in the President's budget. Each division in the Department used the economic asumptions to project their estimates for current law estimates, using inflation factors to calculate out-year projections. Resource levels contained in the FY 1989 budget estimates represent a balance between the goals of reducing the federal deficit, and promoting the President's policy priorities. Obviously, amendments and supplementals would continue to be available to adjust resource levels based on varying needs and priorities.

Question

AIDS, NIH, and Full-Time-Equivalent Staff Positions

Mr. Miller, in your prepared statement you indicate that the President's FY89 Budget request includes $2 billion for "AIDS research, education and treatment." I know the Public Health Service request is $1.3 billion. Where does the other $700 million come from?

Where else in the budget do we list how much we pay for diabetes, or heart disease, or cancer treatment under entitlement programs? We don't. This committee has no discretion over actual entitlement expenditures. I suggest that when you come before this committee you make a distinction between entitlement and discretionary spending. Don't muddy the waters over what we pay as an entitlement and what we should be investing in research, education and alternatives to hospital health care.

Response:

We have estimated that the Federal government will expend a total of $2,026 billion on AIDS in FY 1989. This is a conservative figure which, based on more recent data just provided by the Department of Health and Human Services, should be increased to $2,162, as shown on the attached table.

Selective data on total research and treatment spending is available on a regular basis for end stage renal disease, heart transplants, and other conditions and procedures. In some cases, cross-cutting data on certain conditions have also been collected for interested congressional committees.

Attachment:

Acquired Immune Deficiency Syndrome
Government-wide Crosscut
(Obligations in $ millions)

04-Mar-88

	FY82 Actual	FY83 Actual	FY84 Actual	FY85 Actual	FY86 Actual	FY87 Estimate	FY88 Estimate	FY89 Estimate
Public Health Service	6	29	61	109	234	502	951	1,300
Medicaid (Federal share) ...	*	*	*	*	130	210	375	600
Social Security	*	*	*	*	*	41	71	111
Medicare	*	*	*	*	*	10	15	25
Veterans	2	5	6	12	24	30	52	66
Defense	0	0	0	0	79	74	52	52
Prisons	*	*	*	0	1	3	6	6
State	0	0	0	0	0	1	2	2
Labor	0	0	0	0	0	1	1	1
TOTAL	8	34	67	121	467	872	1,523	2,162

Public Health Service

The Public Health Service supports research into the causes, prevention, and potential cures of AIDS. Through education, PHS also attempts to prevent the further spread of AIDS.

Medicaid and Social Security Disability Insurance

HHS deems AIDS patients to be disabled, which qualifies them for Social Security Disability Insurance (SSDI) benefits and in certain circumstances, for Supplementary Security Income (SSI) benefits. In many States, SSI eligibility may guarantee them Medicaid eligibility.

Veterans Administration

VA provides medical care to veterans with AIDS. The estimates for 1988-89 are subject to wide variation. This is a conservative estimate which assumes that the 1987-89 increase in cases will not exceed the 1986-87 increase.

Defense

Defense is screening current personnel and recruits for evidence of AIDS infection. Personnel found to be antibody-positive may remain in the service and receive treatment. As the backlog of current personnel are screened, required funding will decline.

Bureau of Prisons

The Bureau of Prisons randomly tests asymptomatic inmates entering Federal prisons, and uniformly tests all persons being released from Federal prisons. Medical staff treat inmates with AIDS. Beginning in FY88, all prisoners with AIDS will be offered AZT.

Department of State

Pursuant to recent regulatory changes required by the FY87 Supplemental, State will test refugees and persons seeking immigrant visas for AIDS antibodies. State also conducts AIDS antibody tests as part of routine in-service physical examinations of Foreign Service Officers and physical examinations for new employees.

Labor

Based on the results of a pilot test, DOL plans to begin screening current Job Corps enrollees and new applicants for evidence of AIDS infection. Participants found to be antibody-positive will be given two choices: 1) participate as a day student only (as opposed to a resident student) or 2) participate in an alternate training setting. Costs should decline after the screening of current enrollees is completed in FY87. OSHA will be preparing educational materials for distribution to health care workers.

Question

Speaking of muddying the waters: Once again I see the budget includes a proposal to drastically cut the staff positions allocated for basic biomedical research. As you know, this Committee continually directs the OMB to maintain certain staff levels at NIH and other HHS agencies. Time and time again OMB ignores this direction and this year is no different. It is perhaps more obvious. In FY89, you propose a small increase in funding for basic biomedical research but cut the positions available for this research by 99. (AIDS research gets an increase of 70 positions - basic research is cut by 99). Last year you proposed robbing basic research dollars to pay for AIDS research. This year you propose robbing staff positions.

Mr. Miller, you can't throw money at research and expect results if there aren't people to do the science and administer the programs. Just as you can't expect trained health care professionals to respond to the health needs of this country if you essentially eliminate health professions training money as the 1989 Budget proposes to do.

Mr. Miller, why does OMB continually tie the hands of scientists at NIH (and the CDC and others) by cutting full-time staff equivalent positions?

Response:

The President's Budget provides a total employment ceiling to the Department of Health and Human Services (HHS), developed in the context of the President's policies on Federal employment, management and productivity improvements, and declining effort in certain low priority areas. HHS is encouraged to allocate its employment ceiling according to the Secretary's priorities. With respect to the Centers for Disease Control, HHS has chosen to maintain FY 1989 ceiling employment at the FY 1988 level of 4,405 FTEs plus 606 ceiling exempt FTEs who are primarily State and local government assignees.

In total scientific and overhead staff, employment at the National Institutes of Health (NIH) will increase by 276 FTEs to 13,001 FTEs, or 2.2 percent, from FY 1987 to FY 1988. The FY 1989 NIH FTE ceiling totals 12,902 FTEs, reflecting NIH's continuing management improvements. Of course, the number of working scientists is the appropriate measure of NIH research capacity. We are unaware of any employment ceilings on working scientists, who make up about 25 percent of NIH FTEs. In general, personnel management policies will bring about greater efficiencies in administrative stuctures and overhead.

Question

Why would you eliminate specific funding for health professions training when we desperately need nurses and other health care workers trained in geriatrics, pediatrics and in some cases the special needs of those with AIDS?

NOTE: Congress appropriated $212 million in specific line items for health professions training including specific dollar amounts for geriatric training, nurse training, etc. The Administration proposed one pot of money ($40 million) for which a whole host of entities may apply for any and all areas of health professions training.

Response:

Given the success of 25 years of health professions subsidies, we believe that it is no longer appropriate to continue funding health professions programs at the same level. Our nation has experienced a 54 percent increase in the number of physicians per capita over the period 1965 to 1986. In 1961 there were 86 medical schools with 30,000 students; in 1987 there were 127 schools with 66,000 students. The supply of physicians in the aggregate is adequate.

The President's FY 1989 Budget proposes to address remaining problems related to the supply and distribution of practitioners trained in geriatrics and family medicine, two areas in which the supply of practitioners is not expected to outstrip demand by 1990. Training opportunities for minorities and disadvantaged students will be emphasized.

Part of the $40 million proposed for health professions in FY 1989 would be available for nurse training. The Administration's focus, however, is on training skilled nurses and improving the quality of nursing rather than increasing the overall supply of nurses. We believe that hospitals have increased their demand for nurses because nurses are the least expensive/most productive health care workers available. Increasing the supply of nurses would diminish nurses' bargaining power, and in the longrun could reduce their wages. What is needed is reform in the hospital system -- higher wages for current nurses, better career opportunities and professional development. Hospitals that recognize this fact, such as Beth Israel Hospital in Boston, MA are having no trouble recruiting nurses. Increasing the supply of nurses will maintain the status quo in hospitals and provide hospitals with a ready supply of productive yet underpaid nurses. HHS Secretary Bowen has appointed a Commission to review all of these related issues.

HHS grants are only one source of Federal funds available to health professions students and schools. Federal contributions to health professions and nursing student loan revolving funds, combined with the multibillion dollar Department of Education and Department of Health and Human Services loan guarantee programs, have established a continuing foundation of Federal health professions student aid.

Question

Mr. Miller, given the overall budgetary constraints under which we are forced to operate, it is somewhat astonishing that your FY 1989 Department of Education request amounts to about a 50 percent increase over your request for FY 1988. It is even an increase over the 1988 appropriated level. Believe me, I think this is a step in the right direction but it is not to say the education budget is perfect or reflects the priorities Congress consistently asserts in its appropriations for education programs. For example, there are many places in the education budget where the Secretary's discretionary programs are proposed for large percentage increases while legislatively mandated programs are limited to minimal increases which in fact result in a cut below this year.

The budget request for the Secretary's discretionary fund is a 100 percent increase over the 1988 appropriation. The Education and Statistics program is proposed for a 20 percent increase.

The same budget provides only a 2 percent increase in special education for the handicapped programs. This limited increase actually results in a decrease in the federal contribution toward these programs. (In 1988 the Federal Government contributes 9 percent toward the cost of the special education state grant program. The President's budget would reduce this contribution to 8 percent. The law calls for 40 percent!

Mr. Miller, why does this Administration continually propose underfunding the special education program year after year, while at the same time proposals to increase the Secretary's discretionary fund, and research accounts, etc. are included in the same budget? Does this Administration support 94-142 and its commitment to special education programs? If so, why isn't this commitment reflected in your budget documents?

Response:

The President's budget each year reflects a set of judgments about how best to allocate available Federal resources among the many thousands of programs in light of the set of constraints operating at that time. Within the Education Department, the budget balances competing demands for Federal support of activities at different educational levels and for the benefit of different constituent groups.

The 1989 budget once again reflects the priority placed on improving education services for the population of Americans with disabilities. The budget includes an overall increase of $48 million over the FY 1988 appropriation to help meet increased costs in all State grant programs, and to maintain support for all discretionary activities.

The Administration believes that there is a clear Federal role in this area and is committed to continuing support for special education programs. The amount requested for the major Part B program represents an increase over the prior year's appropriation.

The amount requested in 1989 for the Part B program, $1.5 billion, is estimated to provide $348 for each child that will be counted under the Part B program formula. The request would provide 9 percent of the estimated National average expenditure per pupil, the same share as the 1988 appropriation represents of the estimated National average per pupil expenditure for 1988. At no time in the history of the Part B program has the Federal share of average per pupil expenditure been above 12 percent. The 40 percent figure that is mentioned in the question is a multiplying factor used in the Part B fund distribution formula. It is the same multiplying factor used in the compensatory education program. In neither case does the 40 percent amount represent a mandated Federal share of funding.

Question

Low Income Home Energy Assistance Program (LIHEAP)

Mr. Miller, I think many members of this committee will be interested in the Administration FY 89 request for the Low Income Home Energy Assistance program. The proposed cut of $600 million in this program last year was one of the more controversial issues the Labor-HHS Subcommittee addressed in its mark-up of a bill. Much to my regret we were able to restore only about $300 million of the proposed cut. This year, the Administration is proposing an even bigger cut than it had proposed in 1988. In 1988, the Administration proposed cutting the $1.8 billion program to $1.2. This year, the Administration is asking for even slightly below $1.2 billion. This request is $345 million below 1988 and more than $600 million below 1987.

Mr. Miller, what assumptions were made when you were calculating this figure for FY 89? Have you given any thought to the consequences of such a cut if the States don't or can't pick up the slack?

Response:

The Administration's request for FY 1989 is only $50 million less than your committee's recommendation for FY 1988. There are two reasons the Low Income Home Energy Assistance program (LIHEAP) needs fewer dollars in FY 1989. Your committee cited one of these reasons last year when recommending a $1.2 billion appropriation level for FY 1988 -- the availability of hundreds of millions of dollars in oil overcharge funds, with a lot more to be distributed to States.

The second reason for requesting $1.2 billion relates to your second question -- what happens if the States choose to spend the oil overcharge funds for other purposes. Many other income maintenance programs include a component for heating costs. The Low Income Home Energy Assistance program (LIHEAP) was phased in when home heating costs were increasing more rapidly than inflation as a whole. As a percent of income, heating costs were rising for people with incomes indexed to the Consumer Price Index (Social Security and SSI recipients) and other low income households. In 1984, low income households spent an estimated 5.9 percent of their cash income on home heating. The estimate for 1986, the last one published, was 5.1 percent. Now, Social Security and SSI benefits are increasing more rapidly than home heating prices. Open-ended Federal matching is available to States to provide AFDC recipients with heating supplements. Families with proportionately high shelter costs receive an additional $1.5 billion per year in Food Stamps to offset them. As you can see, the Federal government provides energy assistance in many ways.

QUESTIONS SUBMITTED BY SENATOR WEICKER

Five Year Defense Program

Background

Section 114 (g) of Title 10, United States Code, as amended by Section 1203 of the National Defense Authorization Act for fiscal years 1988 and 1989, requires the Department of Defense to submit annually to Congress by April 1 the Five Year Defense Program (FYDP) used in formulating the budget request.

In testimony before the Senate Armed Services Committee last Thursday, February 18, 1988, Secretary of Defense Carlucci stated that he had not prepared a five-year program for FY 1989-93 but was beginning the process of preparing one in support of next year's budget request covering FY 1990-94.

Question

In view of Secretary Carlucci's recent testimony, please explain the origin and significance of the five-year budget projections for DOD for FY 1989-93 presented in the summary tables of the Budget of the United States Government, FY 1989 (pages 6g-8 and 6g-16)?

Response:

The President's defense budget proposals for budget authority and outlays are consistent with the Bipartisan Budget Agreement for 1988 and 1989. After 1989, defense budget authority is projected to increase by about 2 percent in real terms. These projections represent the planning guidance upon which the Defense Department's five-year program is currently being prepared.

QUESTIONS SUBMITTED BY SENATOR MCCLURE

Question

What is the status of the line item veto package the President discussed during his State of the Union Address? Can you provide any details of this package?

Response:

The package was submitted to Congress by the President on March 10, 1988. The package includes 107 items totalling $1.0 billion in budget authority that were added to the Continuing Resolution. The total Federal project cost for these items is $4.3 billion.

Question

After Congress completed work on the FY86 Appropriations bills, the Administration proposed deferrals and rescissions for many of the Congressional add-ons. The Administration budget request was generally ignored in that deferral and rescission package.

During this hearing after the package was released in 1987, you assured me that OMB continually reviews on-going budget that were previously approved.

What percentage of this package is from the original Administration request for FY88?

If very few, then when and why did OMB's policy of continual review of your original request change?

Response:

None are from the original Administration request for FY 1988. The Administration continually reviews its spending plans. The major difference here is that the Administration does not request that its project proposals be included in law since this makes it more difficult to adjust to changing conditions and priorities. The wasteful project list is 100 percent required by law, even if changing conditions dictate further review.

Question

In previous years, the Subcommittee has given the Departments of Interior and Agriculture the authority to use "no year" funds for suppression and emergency prevention of forest or range fires. The authorizing language allowing the transfers of these funds require that the funds "be replenished by a supplemental appropriation which must be requested as promptly as possible."

The budget agreement on the deficit between the President and the joint leadership of Congress specifies that for FY88 neither the Congress nor the President shall initiate supplemental appropriations except in the case of dire emergency.

In the FY88 Continuing resolution, Congress provided $125 million of the necessary $260 million for fires on Forest Service lands. The total amount was not provided at the time because it was simply not known.

In the budget submission for FY89, the Administration did not request the remaining funds in either a supplemental or in the regular appropriation bill.

If the Administration is not going to submit a request for the remaining firefighting funds, are you assuming that the Forest Service will simply absorb the remaining $125 million?

Response:

The Forest Service transfers amounts necessary from the Knutson-Vandenberg (K-V) Cooperative Work Fund to cover forest firefighting costs. This fund typically has large unobligated balances which are held in a contingency reserve to cover work requirements in future fiscal years. The current reserve is sufficient to prevent any negative impacts to the anticipated K-V program level in FY 1988 or FY 1989 resulting from the transfer of funding for firefighting. When the K-V Fund requires reimbursement to accomplish anticipated work in an efficient manner, the remaining $125 million can be requested.

Question by Senator McClure:

Would you recommend vetoing a supplemental replenishing the fire accounts?

Response:

We would oppose a supplemental appropriation for firefighting expenses in 1988 to reimburse the K-V Fund. The Bipartisan Budget Agreement between the President and the joint leadership of Congress precludes the Congress and the President from initiating supplementals except in the case of dire emergency. This is not an emergency situation. The transfer of funding from the K-V Cooperative Work Fund for firefighting will not have an adverse impact on the program due to the large contingency reserve in the Fund.

Furthermore, in testimony before Congress on November 10, 1987, the Forest Service stated that the cost of fire suppression efforts for FY 1987 was $260 million. This provided Congress with sufficient time to adjust the 1988 appropriation for the total firefighting costs if Congress determined that it should be funded in 1988.

Question

Doesn't the Administration consider fires emergencies?

Response:

The issue is not whether forest fires are emergencies by whether funding to reimburse amounts transferred for firefighting purposes qualifies as an emergency. Since the K-V Fund is not adversely affected, this is clearly not an emergency circumstance.

Question

Please provide for the record the annual outlays you anticipate from the Clean Coal Technology Program until your request for budget authority is gone.

Response:

Projected annual outlays from the Clean Coal Technology Program until the budget authority requested is gone are as follows:

Fiscal Year	Outlays in Millions
1989	162.7
1990	324.3
1991	487.0
1992	550.8
1993	527.5
1994	393.8
1995	180.0
1996	60.0

QUESTIONS SUBMITTED BY SENATOR GARN

Question

Dr. Miller, the President has proposed nearly a 30% increase for general science, space and technology programs in the FY 1989 budget. This is not only the largest functional increase contained in his budget on a percentage basis, but at $3.1 billion, it is also the largest increase in gross dollars for any non-defense function.

I strongly concur with the high priority that the

President has placed for these activities and believe, as he does, that they are critical to our Nation's future. However, after the trial and frustration of working with the current year budget, and the adoption of a overall two percent Budget Authority increase as part of the "Summit Deficit Agreement", its obvious to all of us that such an increase for science and space will be very difficult to sustain.

Do you view this proposed increase for science and space as consistent with the "Summit Deficit Agreement"?

Response:

Yes, the President's FY 1989 budget proposals for science and space (budget function 250) are completely consistent with the Bipartisan Budget Agreement. The Agreement sets budget authority and outlay limits for the broad categories of domestic discretionary, international affairs (function 150) and defense (function 050). The limits for domestic discretionary spending are $148.1 billion in budget authority (BA) and $169.2 billion in outlays. The President's budget meets the BA and outlay limits.

However, the Agreement does not set limits on programs within any of the categories and it does not prohibit the President from making choices and setting priorities among programs within each of these categories. The science and space programs, which are contained in the domestic discretionary category, have been a high priority of the Administration from the beginning, and they will continue to be so. The President has shown great leadership and foresight in continuing to propose and to press for these important investments in the Nation's future.

Question

It's a natural political reaction to budgetary constraints to maintain existing programs as much as possible, thereby leaving almost no "room" or flexibility for new priorities or initiatives. In fact, there are many who believe that with an aggregate increase for BA of 2% for non-defense discretionary programs, we on the Appropriations Committee, in our FY 1989 budget allocation, should merely adjust each subcommittee's totals by 2%.

First, what reaction do you have to this notion, and second, if we sent individual appropriations bill to the President based on such an allocation, would they be signed? Wouldn't they be consistent with the "Summit Deficit Agreement"?

Response:

My reaction is that a simple, across-the-board allocation is not the most appropriate way to budget for our national needs.

The Administration made many hard choices in the fiscal year 1989 budget. Funding levels for some programs identified as priorities were increased, while other programs were decreased. Good public policy requires that government make such choices so the greatest needs of the people are addressed. Congress should also take a leadership role by allocating resources where they are most needed.

While I cannot say at this time whether the President would sign or veto appropriations bills that are based on an across-the-board two percent allocation, it is clear that such an allocation could jeopardize some programs that the President has given high priority. Programs that could be adversely affected include: the NASA space station, the NASA Pathfinder, the Superconducting Super Collider, the National Science Foundation, Department of Justice law enforcement, Federal correctional activities, and many others.

Therefore, even if appropriations bills, in aggregate, meet the constraints of the Bipartisan Budget Agreement, I believe the President would reserve the right to veto individual bills if his priorities are set aside. I urge Congress to continue to work with us during the coming months so this does not happen.

COMMITTEE RECESS

Chairman STENNIS. You have covered this entire matter, but we will be calling on your again. It is a long way to the end of this session, as you know. I like to think about and refer to last year when we were working on that continued week to week meeting. I was impressed with your knowledge then, your concern and willingness to offer something constructive.

Mr. MILLER. Thank you sir.

Chairman STENNIS. It is bearing fruit in a very fine way.

Is there any other matter now to come before the committee?

[No response]

Chairman STENNIS. Otherwise, the committee will recess, subject to the call of the Chair.

[Whereupon, at 11:55 a.m., Wednesday, February 24, the committee was recessed, to reconvene at the call of the Chair.]

BUDGET OVERVIEW FOR FISCAL YEAR 1989

TUESDAY, MARCH 1, 1988

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 10:02 a.m., in room SD-192, Dirksen Senate Office Building, Hon. John C. Stennis (chairman) presiding.

Present: Senators Stennis, Chiles, Johnston, Burdick, Sasser, DeConcini, Bumpers, Lautenberg, Stevens, Kasten, Specter, Domenici, Grassley, and Nickles.

DEPARTMENT OF THE TREASURY

SECRETARY OF THE TREASURY

STATEMENT OF THE HONORABLE JAMES A. BAKER III, SECRETARY OF THE TREASURY

OPENING STATEMENT OF CHAIRMAN STENNIS

Chairman STENNIS. Ladies and Gentlemen, the hearing will come to order.

This morning, our Appropriations Committee will continue with the second of three overview hearings on the President's proposed budget for fiscal year 1989. Today we will hear testimony from the Honorable James A. Baker, III, Secretary of the Treasury.

Mr. Baker, let me commend you as well as thank you for the contribution you are making, and particularly last year at the meeting we had, called the Summit Hearings, where you gave me a feel, and I am sure you gave it to others, that you had prepared yourself, you were on the right trail, going in the right direction. I sensed early that you were going to make a real contribution, as well as others, and that good would come from this meeting that we were holding.

Good doesn't come from all such meetings, but it did there, and we reached a satisfactory and practical agreement. That same agreement has continued on, did not phase out or play out, but it has gained strength this year, you can feel it. The fruits are already being borne of that agreement. I commend you highly and thank you also.

This is the second of three overall hearings that we plan. This is the second one of the three. I like the idea that administration representatives come and submit to questions. It gives every member of the committee a chance to ask questions, send questions in, if they can't come.

The press has access, of course, to the questions and answers. Good comes from such hearings, even though the immediate presence may not score very high because there are so many other things to be done.

In the third hearing, I will mention it now, we hope to have it as early as March 4, Friday of this week, is the final overview hearing when the Acting Director of the Congressional Budget Office, James L. Blum, presents his annual analysis of the President's budget proposal to the committee.

We wish you a special welcome this morning. This big job that you have and those who are associated with you, in fact anyone connected with the government now is on the spot considerably. We have always been able to find a way out, and I believe we will in this, but there is no time to be lost.

NATIONAL DEBT

We have a national debt which now is projected at $2.8 trillion in fiscal year 1989. It has tripled in the last 7 years. We are also concerned about the $152 million annual interest payment on the national debt, the third largest item in the President's budget this year, coming after defense and social security.

We are concerned about the transformation of our Nation from the world's largest creditor nation in 1981 to the world's largest debtor nation today.

I am reviewing these matters here so as to get the facts. I don't have a full solution to all of these problems, but there are a whole lot of people travelling in the same direction who are looking for solutions. I believe, as a practical matter, if we keep looking and work hard enough, we will find that solution.

We are concerned also about the Federal budget deficit and the legacy of debt which we are passing on to our children and grandchildren.

Mr. Secretary, although these problems are highly significant, I definitely feel that progress is possible, and that we are making some progress already.

I have already paid my respects to you, and the others who helped, with reference to the Budget Summit Agreement we had last fall, and how they are working their way into this budget this year, is not only a basis for not only hope but reality of things to help get along with this budget.

We will call on the Secretary, of course, and then get to the membership, as soon as we can, to not only hear the answers that he has given, but have a chance to make your own contribution in such a way that you might wish.

Mr. Secretary, in your own way, would you proceed?

Secretary BAKER. Mr. Chairman, if it is all right with you, I will just summarize my prepared testimony and ask that the statement be submitted for the record.

Chairman STENNIS. It is entirely all right. Without objection, we will put the entire statement in the record. You go ahead and make such other remarks as you wish.

STATUS OF U.S. ECONOMY

Secretary **Baker**. Mr. Chairman, I think that it is fair to say that the United States economy exceeded almost all expectations in 1987, and in our view prospects for continued expansion this year are encouraging.

U.S. EXPANSION

The current expansion that the United States is in is now in its 64th month. It is the longest peacetime expansion on record. Income and employment have risen impressively, while inflation has been held to a reasonably moderate pace. We projected 3.2 percent real growth over the four quarters of 1987. You will recall that the consensus of private economists was a little less than 3 percent. As it turned out real growth was about 3.8 or 3.9 percent, exceeding our own projection as well as the consensus of private sector forecasters.

UNEMPLOYMENT DROP

During 1987, Mr. Chairman, the civilian unemployment rate dropped by nearly 1 full percentage point, from 6.7 percent in December of 1986 to 5.8 in December of 1987, which happens to be the lowest rate of this decade. Employment rose by about 3 million people in 1987, bringing the gain across the entire expansion to more than 14.5 million new jobs.

Mr. Chairman, this is more jobs than Western Europe and Japan have created in the last 2 decades. At the end of last year, the percentage of the working age population that was employed in the United States was an all-time high.

INFLATION RATES

Last year's inflation rates were higher than they had been in 1986, but this reflected the 1986 drop and subsequent rise in oil prices. The U.S. inflation rate has averaged less than 4 percent over the expansion, which I think is a remarkable achievement.

In the past, the rate of inflation has typically risen as an expansion has proceeded, necessitating a more restrictive policy which could endanger continued growth. But such inflationary pressures have not appeared in the current expansion.

PROGRESS IN MANUFACTURING AREA

Our progress in the manufacturing area has been particularly striking, I think. Industrial production rose by 5.4 percent over the 12 months of 1987, following an increase of only a little more than 1 percent during 1986. Employment in manufacturing rose by 410,000 people during 1987, following declines in each of the two previous years.

Much of the rebound in manufacturing reflects a revival of America's exports as a more reasonably valued dollar lets the competitiveness of United States producers shine through. In volume terms, U.S. merchandise exports in the fourth quarters of 1987 rose twice as fast as any other yearly increase in this expansion.

By almost any criteria this has been a sound economic performance, and one that should serve as a solid foundation for continued growth in the coming year.

ADMINISTRATION FORECAST

The administration forecast for 1988 reflects the divergent forces that had emerged by the end of 1987. On the one side, industrial production remains robust. On the other, consumer demand appears to be slowing. Consequently, we expect real growth to moderate from the 3.9 percent across the four quarters of 1987 to 2.4 percent during 1988.

On balance, inflation in 1988 should be little changed from 1987. We project consumer prices to increase in 1988 by a little less than they did in 1987. We expect a rebound to a growth rate of 3.5 percent across the four quarters of 1989.

It is our judgment, Mr. Chairman, that if sound economic policies are pursued, including steady, moderate growth of the monetary aggregates and continued reduction in the budget deficit through restraint of spending, there is no reason for the turmoil in financial markets of last fall to lead to an economic downturn.

TRADE BALANCE

An important impetus to growth this year should come from further improvement in the trade balance. The impact of the decline in the dollar in foreign exchange markets, accompanied by policies designed to stimulate growth abroad, has led to a shift in the composition of the U.S. gross national product toward rising exports and substitution of domestic production for imports.

Since the third quarter of 1986, when the dollar merchandise trade deficit in volume terms was at its widest, improvement in the real merchandise trade balance has accounted for fully one-fifth of the growth of real GNP.

The agreements made by the major industrial countries, as evidenced at the Louvre last February, in Washington last April, and in last December's Group of Seven statement, paved the way, we think, for a continued resolution of external imbalances and, hence, additional export-led growth for the United States of America.

United States deficit spending is being curtailed. Japan is pursuing economic policies to sustain strong growth. Germany has taken measures to improve growth, including advancing tax cuts and providing additional investment incentives.

With the world economy just starting to benefit from our efforts to encourage international cooperation, we, in the United States, could not pick a worse time to resort to protectionism. Nothing would more surely close foreign markets and create unnecessary uncertainty than legislation which serves to close United States markets.

BUDGET PROGRESS

We made substantial budget progress in fiscal year 1987, Mr. Chairman, as you noted in your opening statement. The final statistics show $150 billion deficit, 3.4 percent of GNP, in fiscal year 1987, down $71 billion from the $221 billion, or 5.3 percent of GNP, deficit in fiscal year 1986. Relative to GNP, the 1.9 percentage point reduction in a single year is a major accomplishment.

Even though we benefited somewhat from higher than expected revenues from the Tax Reform Act of 1986, the keys to our success were and have to continue to be spending restraint and sustained economic growth. After adjusting for inflation, Federal outlays actually fell in fiscal year 1987, the first such decline in 14 years.

Looking forward, we made even further progress as a result of the 1987 Budget Summit and its associated legislation. This is reflected in the substantial improvement in the current services estimates.

Under current services projections, the deficit is projected to fall significantly in the coming years. But, of course, there is still work that has to be done.

Congressional adoption of the President's budget proposals to implement the remainder of the Budget Summit Agreement would continue to move the Federal Government along the path of needed expenditure control and would reduce the deficit even faster.

Because of the progress that has been made to date, the policy changes in the President's budget relating to deficit reduction are not as large as they have been in previous budget submissions, and they really should be readily achievable by the Congress.

The proposed budget would reduce the deficit from $147 billion in fiscal year 1988 to $130 billion in fiscal year 1989, or from 3.1 percent of GNP to 2.6 percent of GNP, a clear message to the American people and to financial markets that deficit reduction is firmly in place, and to $23 billion in fiscal year 1993, which represents only four-tenths of one percent of GNP.

IMPORTANT POINTS IN FISCAL 1989 BUDGET

Two important turning points are projected in the fiscal year 1989 budget. These turning points reinforce the message to financial markets that the deficit is under control.

As the first chart attached to my written statement demonstrates, interest payments on Federal Government debt as a share of the budget are projected to decline after fiscal year 1988. No longer, Mr. Chairman, will growing interest payments force contraction in other parts of the Federal budget.

As the second attached chart shows, the economy is growing faster than the national debt. By fiscal year 1992, the debt will be rising less rapidly than the rate of inflation and will actually be falling in real terms.

Mr. Chairman, it is the strongly held view of this administration, as I am sure you know, that the American people are not undertaxed, the government has overspent. As shown by the third chart attached to my statement, Federal revenues, as a share of GNP, have generally exceeded their 1964 to 1979 average during the past 7 years, and projected over the next 6 years to average one full percentage point above this historical norm. Meanwhile, the Federal budget's outlay share of the GNP has, on average, exceeded the 1964 to 1979 average by 3.5 percentage points during the past 7 years.

This budget does not contain any major new tax proposals. In light of the landmark changes in our tax structure brought about by the Tax Reform Act of 1986, we think that it is imperative that we give individual taxpayers, businesses, investors, and even government, some breathing room and a chance to adapt.

While we are succeeding in reducing our budget deficit, the budget process itself has fallen into disarray. For two consecutive years Congress has delivered a mammoth omnibus appropriations bill well into the fiscal year that has to be signed in a matter of hours or else the government will have to shut down. The budget process must be reformed, root and branch.

FUTURE PROJECTIONS

In conclusion, Mr. Chairman, we enter 1988 with cautious optimism. The economy continues to exhibit considerable forward momentum. Employment growth remains strong, and inflation is under control. The continued restraint of government spending in the President's fiscal year 1989 budget is an extension of the policies that have promoted strong, sustainable, non-inflationary economic growth.

I am sure, Mr. Chairman, that by working together, the administration and the Congress can provide a budget that consolidates our hard fought gains on deficit reduction, without sacrificing funding for the necessary and important functions of government.

I would be happy to respond to your questions.

[The prepared statement of Secretary Baker follows:]

PREPARED STATEMENT OF HON. JAMES A. BAKER, III
SECRETARY OF THE TREASURY

Mr. Chairman and Members of the Committee:

It is a pleasure to meet with you today to discuss the economic outlook and the Administration's budget.

1987 in Review

The pace of U.S. economic growth improved in 1987, exceeding almost all expectations. Prospects for continued expansion this year are encouraging despite the stock market decline. Exports are growing strongly and the improving real trade balance continues to add to domestic output growth. We have made considerable progress on the Federal budget deficit. Last year's budget summit and ensuing legislation were positive steps toward ensuring that this progress will continue.

The current expansion is now in its 64th month and is the longest peacetime U.S. expansion on record. Income and employment have risen impressively while inflation has been held to a moderate pace.

While our focus today should be on the present and the future, it is worthwhile to review last year's experience. At the beginning of last year, some forecasters doubted that a strong expansion would continue. The Administration was criticized by some for issuing an overly optimistic forecast. We projected 3.2 percent real growth over the four quarters of 1987. The consensus of private economists projected a little less than 3 percent growth and a few economists were warning of recession. As it turned out, real growth was 3.9 percent, exceeding our own projection as well as the consensus of private sector forecasters.

Continued expansion of the economy last year led to lower unemployment rates and a high rate of job creation.

- During 1987, the civilian unemployment rate dropped by nearly one full percentage point from 6.7 percent in December 1986 to 5.8 percent in December 1987, the lowest rate of this decade. The unemployment rate for blacks was down by 1-1/2 percentage points and that for Hispanics by more than 2 percentage points.

- Employment rose by about 3 million persons in 1987, bringing the gain across the entire expansion to more than 14-1/2 million. This is more jobs than Western Europe and Japan have created in the last two decades. By the end of last year, the U.S. employment ratio (those working as a proportion of the working-age population) was at an all-time high.

Last year's inflation rates were higher than they had been in 1986 but this reflected the 1986 drop and subsequent rise in oil prices. The U.S. inflation rate has averaged less than 4 percent over the expansion--a remarkable achievement. In the past, the rate of inflation has typically risen as an expansion has proceeded, necessitating more restrictive policy which could endanger continued economic growth. But such inflationary pressures have not appeared in the current expansion.

Our progress in the manufacturing area has been particularly striking. The resurgence of U.S. manufacturing was an important feature of last year's economic developments.

- Industrial production rose by 5.4 percent over the twelve months of 1987, following an increase of only a little more than 1 percent during 1986.
- Employment in manufacturing rose by 410,000 during 1987, following declines in each of the previous two years.
- In 1986, the last year for which full international data are available, the United States was the only one of twelve major industrialized countries to register a decline in unit labor costs in manufacturing.
- Much of the rebound in manufacturing reflects a revival of America's exports as a more reasonably valued dollar lets the competitiveness of U.S. producers shine through. In volume terms, U.S. merchandise exports in the four quarters of 1987 rose twice as fast as any other yearly increase in this expansion.

By almost any criteria this has been a sound economic performance, one that should serve as a solid foundation for continued growth in the coming year. Hurdles remain, but they can be overcome with appropriate and timely policy choices.

In the fiscal area, we made welcome progress in reducing the Federal budget deficit. In the 1987 fiscal year concluded last September, the deficit fell by $71 billion--the largest single-year decline on record. While special factors accounted for some of the decline, the key ingredients were spending restraint and robust economic growth. Remarkably, Federal outlays actually fell in real terms for the first time in 14 years.

The budget agreement between the President and the joint leadership of Congress reached late last year is a significant step toward assuring continued fiscal restraint. We believe that we have shown the public and the financial community that the Administration and Congress are able to work together to get control of the Federal deficit.

On the monetary front, 1987 was a year of adjustment by the Federal Reserve. As 1987 began, it was clear that the pace of expansion in the monetary and reserve measures in late 1986 had been excessive and that inflationary expectations were being rekindled. Thus, some deceleration of monetary growth was desirable. The Fed, however, responded immediately to the stock market crash in October in a successful, and widely praised, effort to provide needed liquidity to the financial system. By the end of the year, interest rates were down from their October highs, but moderately higher than they had been at the beginning of the year.

Economic Forecast for 1988 and Beyond

The Administration forecast for 1988 reflects the divergent forces that had emerged by the end of 1987. On the one side, production remains robust as the industrial sectors demonstrate substantial forward momentum. On the other side, domestic demand appears to be slowing as consumers respond to the dramatic decline in stock prices last fall and the lagged effects of a more cautious monetary policy during last spring and summer. Consequently, we expect real growth to moderate from the 3.9 percent across the four quarters of 1987 to 2.4 percent during 1988.

On balance, inflation in 1988 should be little changed from 1987. We project consumer prices to increase in 1988 by a little less than in 1987.

Following relatively moderate real GNP growth this year, we expect a rebound to a growth rate of 3-1/2 percent across the four quarters of 1989. For the years thereafter, we have projected that the economy will gradually move to a position of relatively full utilization of resources. Of course, it is impossible to forecast the exact path of activity over the longer term, and we recognize that actual movements of the economy will be far more cyclical than the smooth path in these working assumptions.

The Administration forecast of real growth this year is well within the range of private forecasts. It is just slightly ahead of the Blue Chip consensus of about 1.8 percent, fourth quarter to fourth quarter, which is also the figure projected by the Congressional Budget Office. As already noted, our forecast for 1987 came closer to the mark than either the private consensus or CBO. The Administration forecast has underpredicted real growth in three of the last five years of economic expansion.

Admittedly, there are a number of uncertainties in the outlook for this year. When we first began preparation of the forecast for the FY 1989 budget, the decline in the stock market had only recently occurred. Many private analysts were predicting that its impact on household balance sheets and hence on consumer spending would be so severe that the economy would be tipped into recession. Other analysts were more impressed by the considerable forward momentum of the economy and were concerned that it would proceed at such a pace as to reignite inflationary pressures.

Subsequent events appear to have confirmed that the middle course chosen for the Administration forecast was the correct one.

- Clearly, the forward momentum of last fall has been tempered. Consumer spending slowed somewhat toward the end of 1987, perhaps partly in response to the stock market decline, though the pattern of consumer spending had softened noticeably earlier in the year. Inventory imbalances have emerged in scattered segments of the economy, most notably at retail trade.
- On the other hand, the pace of new order placement with manufacturers and the mounting backlog of unfilled orders confirm that there remains substantial forward momentum in the industrial sector.
- Moderation of consumption, higher saving and rising orders have coincided with a shift in activity toward export-led growth and a larger role for business fixed investment.

It is our judgment that if sound economic policies are pursued -- including steady, moderate growth of the monetary aggregates and continued reduction in the budget deficit through restraint of spending -- there is no reason for the turmoil in financial markets of last fall to lead to an economic downturn. Nor would there be reason for the forward thrust of the industrial sector to get out of hand and generate the types of excesses that eventually resulted in downturns in the past.

An important impetus to growth this year should come from further improvement in our trade balance. The impact of the decline in the dollar in foreign exchange markets, accompanied by policies designed to stimulate growth abroad, has led to a shift in the composition of U.S. GNP growth toward rising exports and substitution of domestic production for imports. Since the third quarter of 1986, when the dollar merchandise trade deficit in volume terms was at its widest, improvement in the real merchandise trade balance has accounted for fully one-fifth of the growth of real GNP, as the real volume of our merchandise exports rose at an annual rate of 18 percent while imports increased at a rate of only 4 percent. The latter represents a marked slowing from the 14 percent annual rate of growth averaged across the three previous years.

- The dramatic improvements in the tradable goods sector of our economy are illustrated by the increase in production of steel by U.S. mills of one-third in the fourth quarter of last year from a year earlier. This, along with a rationalization of productive capacity, has propelled the capacity utilization rate in the steel industry to 95 percent, the highest since 1978.

- To cite another example, the value of shipments in the semiconductor industry jumped 13 percent last year measured in nominal terms and by more than that if correction is made for declining prices in the industry. The trade gap in semiconductors has been cut by more than one-half from the $2-1/4 billion deficit in 1984.

Overall, rising production has pushed up operating rates to some of the highest levels witnessed since the 1960s in such industries as paper, textiles, chemicals, and rubber and plastics. These high capacity utilization rates, along with a dramatic improvement in profits in the industrial sector, imply continued strength in business capital spending, another element pointing to sustained economic expansion during 1988.

An additional positive influence this year is the full implementation of the Tax Reform Act of 1986. Though impossible to isolate, some economic activity may well have been postponed until this year when tax rate reduction became fully effective. Spendable incomes of consumers were boosted at the start of 1988 by the reduction of 6 or 7 percent in withholding, though a portion of that is being offset by higher social security tax rates.

The International Economy

With the U.S. economy turning to export-led growth, developments abroad play an important role in our 1988 outlook. Last year real GNP in the industrial countries grew nearly 3 percent -- the fifth year of sustained expansion from the 1982 recession. We expect another year of 2-1/2 to 3 percent real growth in 1988. Inflation in the OECD countries in the last two years has reached the lowest rates since 1967, and should remain low.

We are also beginning to see progress in reducing external imbalances worldwide, even though more needs to be achieved. Patterns of demand are changing. Last year demand from domestic sources in the United States moderated, while foreign demand for our exports grew sharply. In 1987 real net exports of goods and services added to domestic output growth for the first time since 1982. With domestic demand abroad likely to remain considerably stronger than in the United States, the real trade balance should continue to improve. Furthermore, this substantial strengthening in our real trade balance should also be reflected by lower nominal trade and current account deficits this year.

Over the past years, the major countries have intensified efforts to strengthen international economic policy coordination. The key focus of these efforts has been to achieve reductions in external imbalances in the context of sustainable noninflationary growth and greater exchange market stability. We have made substantial progress in achieving these goals.

At the Tokyo and Venice Summits, the Heads of State or Government of the Economic Summit countries developed and refined a new coordination process, using economic indicators, to assess the consistency and mutual compatibility of policies and to determine if a significant deviation from an intended course was emerging, requiring remedial action. The major countries have also agreed on the basic directions that their policies should follow and--as evidenced at the Louvre last February, in Washington last April, and in last December's Group of Seven statement--have made specific commitments to achieve these ends. U.S. deficit spending is being curtailed. Japan is pursuing economic policies to sustain strong domestic growth, including monetary policies to accommodate declining interest rates. Germany has taken measures to improve growth, including advancing tax cuts, providing additional incentives to investment and reducing short-term interest rates.

The substantial changes in currency values that have occurred are contributing importantly to the reduction of external imbalances. The major industrial nations have agreed, however, that a further decline in the exchange rate of the dollar could be counterproductive. Therefore, the United States has and will continue to work closely with its major trading partners to foster exchange rate stability and I want to assure you that the U.S. will do its part in this effort.

Despite the substantial progress that has been made, there is clearly room for further improvement. We need to make coordination a more effective process for encouraging the sound policies necessary for improved global growth and financial stability. One potentially helpful measure, which I proposed in my speech to the Annual Meetings of the World Bank and IMF, is the use of a commodity price index including gold, as one indicator, among others, of global inflationary and deflationary trends.

In the area of trade policy, the Administration has gone to unprecedented lengths to open up foreign markets, although these measures, of course, can only reinforce our macroeconomic efforts to moderate our international imbalances. We have negotiated a comprehensive bilateral arrangement with enormous potential economic significance, the Free Trade Agreement with Canada. I would like to elaborate briefly on this because of the unprecedented opportunities it presents. Under it, both countries will eliminate tariffs with their largest trading partner, protect rights of investors, enhance energy security, establish a framework for services, and remove many irritants. We have also negotiated a framework agreement with Mexico to address trade and investment issues.

It was largely as a result of our initiative and persistence that the Uruguay Round was launched. We are now through the first stage, that of identifying issues, and are moving into substantive negotiations. We hope, through a mid-term review, to have some preliminary results this fall, particularly in the very important area of agriculture. Bilaterally, we continued to maintain strong measures against unfair foreign trade practices, taking on issues like Japanese cigarette restrictions, Korean insurance, EC subsidies on canned fruit, and Taiwan's restrictions on alcohol.

In view of the recent rapid expansion in U.S. exports, it is particularly important to maintain the momentum in our market opening efforts. Protectionist legislation is always bad. But this would be perhaps the worst of times. Our exporters and their employees are starting to benefit enormously, some from several hard years of cost-cutting and reorientation as well as from international developments. Nothing would more surely close foreign markets and create unnecessary uncertainty than legislation that closes our markets. We should work together to avoid that.

A sound world economy also requires further progress in dealing with the debt problems of the developing countries. The United States will continue to play an active role in coordinating international efforts to address those problems. The success of the present strategy depends critically upon debtor countries' efforts to improve growth in their own economies. Support for market-oriented reforms through new financial flows from international financial institutions and commercial banks is also essential.

Considerable progress has been made under this strategy during the past two years. To help sustain these efforts and ensure adequate international support, we have supported negotiations on a global capital increase for the World Bank. We have also proposed the creation of a new IMF External Contingency Facility to help cushion the effect on IMF standby programs of unforeseen external developments, such as weaker commodity prices or sustained higher interest rates. And, we have encouraged the development of a "menu" of alternative financing options.

In contrast, so-called "comprehensive" or "global" solutions involving transfer of the problem to taxpayers in creditor countries are unacceptable. In addition to the major cost to taxpayers, these proposals are even counterproductive to long-term growth because they would discourage new private money flows in the future, fail to secure market-oriented adjustments in debtor nations, irreparably politicize the problem by consolidating it in a centralized forum and encourage debt repudiation.

Budget and Deficit Overview

We made substantial budget progress in FY 1987. The final statistics show a $150 billion deficit (3.4 percent of GNP) in FY 1987, down $71 billion from the $221 billion (5.3 percent of GNP) in FY 1986. Relative to GNP, the 1.9 percentage point reduction in a single year is unprecedented. Even though we benefited somewhat from higher than expected revenues from the Tax Reform Act of 1986, the keys to our success were, and must continue to be, spending restraint and sustained economic growth. After adjusting for inflation, Federal outlays actually fell in FY 1987, the first such decline in 14 years.

Looking forward, we made even further progress as a result of the 1987 Budget Summit and the associated legislation. This is reflected in the substantial improvement in the current services estimates. Under current services projections, the deficit is projected to fall significantly in the coming years. Earlier in the decade, in the wake of the 1980 and 1981-82 recessions, Federal debt was rising as a share of GNP, and debt service was rising as a share of the budget. Today, we project under current services that Federal debt held by the public as a share of GNP will be flat in FY 1988 and FY 1989, and fall thereafter. Net interest will be falling as a share of GNP in FY 1989 and will be declining absolutely by FY 1992. Still, there is work to be done.

Congressional adoption of the President's budget proposals to implement the remainder of the budget summit agreement would continue to move the Federal Government along the path of needed expenditure control, and reduce the deficit even faster. Because of the progress that has been made to date, the policy changes in the President's budget relating to deficit reduction are not as large as in previous budget submissions, and should be readily achievable by the Congress. The proposed budget would reduce the deficit from $147 billion in FY 1988 to $130 billion in FY 1989 (from 3.1 percent of GNP to 2.6 percent)--a clear message to the American people and to financial markets that deficit reduction is firmly in place -- and to $23 billion in FY 1993 (0.4 percent of GNP).

Two important turning points are projected in the FY 1989 budget. These turning points reinforce the message to financial markets that the deficit is under control. As the first attached chart demonstrates, interest payments on Federal government debt as a share of the budget are projected to decline after FY 1988. No longer will growing interest payments force contraction in other parts of the budget. As the second attached chart shows, the economy is growing faster than the national debt. By FY 1990 the debt will be rising less rapidly than the rate of inflation, and will actually be falling in real terms.

Federal receipts will be growing strongly in absolute terms as the economy itself grows, and as previously scheduled increases in payroll taxes become effective this year and in 1990. Receipts are projected to rise by an average of almost 8 percent annually between FY 1987 and FY 1993, just under the 9 percent rise averaged in the previous seven-year period. Receipts are expected to remain at a relatively constant share of GNP, over the next six years, between 19.2 and 19.5 percent.

The American people are not undertaxed; the Government has overspent. As shown by the third chart attached to my statement, Federal revenues as a share of GNP have generally exceeded their 1964-1979 average during the past seven years and are projected over the next six years to average one full percentage point above this historical norm. In contrast, the Federal budget's outlay share of the GNP has, on average, exceeded the 1964-79 average by 3.5 percentage points during the past seven years. Continued spending restraint, as proposed in the FY 1989 budget, should shrink the share of GNP spent by the Federal government to 19.8 percent in 1993, the lowest it has been since the late 1960s.

This budget does not contain any major new tax proposals. In light of the landmark changes in our tax structure brought about by the Tax Reform Act of 1986, it is imperative that we give individual taxpayers, businesses, investors, and even government, some breathing room -- a chance to adapt. At this time, the single most important contribution to the tax code that Congress can make is prompt enactment of technical corrections to the 1986 Act; and the top tax policy priority at Treasury is completing the implementation of that Act, by issuance of regulations, rulings, and notices which provide taxpayer guidance.

It is especially important that we do not allow the tax reform accomplished in 1986 to be undone. In particular, we must maintain the low rates of taxation for both individuals and corporations. We must not let taxpayers be whipsawed by a tax law that is continually changing. Businesses as well as individuals require a stable tax environment in order to make sensible economic decisions. There are no more important ingredients to sustained economic growth than low tax rates coupled with the promise of certainty.

The summit agreement brings us much closer to a Federal government whose spending takes a relatively smaller proportion of GNP from the private sector. We are confident that the deficit can and should be reduced by continuing to shrink the scope of government through spending restraint and economic growth, rather than by tax rate increases.

Priorities

Last year's budget summit agreement was a major step toward consolidating these gains. That agreement conveyed two important messages to the American people. First, it demonstrated the willingness and the ability of the Administration and the Congress to work together constructively for the common good of the Nation. Second, it signalled that both the Administration and the Congress would not accept government spending set on automatic pilot via the sequestration process in the Gramm-Rudman-Hollings legislation. Make no mistake, automatic spending cuts are preferable to some alternatives, such as no spending cuts at all or higher taxes that slow the economy and undo the benefits of tax reform. But automatic cuts ignore priorities: Programs that may legitimately deserve additional funding are cut right along with those programs that may have outlived their usefulness.

The budget plan proposed by the President continues along the deficit reduction path. It complies with the summit agreement, completing the second part of the $76 billion deficit reduction package, and it provides funding for critical functions of government while cutting back or, in some cases, terminating funding of outmoded programs.

As agreed at the summit, the President's budget provides the financing for the core elements of our defense and international programs. Moreover, discretionary domestic programs will be permitted only a net increase of 2 percent over the level estimated for FY 1988. However, some programs, such as those for education, drug enforcement, and technology development receive larger funding increases, while others are reduced, reformed, or proposed for termination. Examples of programs proposed for termination include the rural housing insurance fund, the Economic Development Administration, Urban Development Action Grants, and Small Business Administration direct loans. The exercise of such priorities is consistent with the agreement and is an essential element in a dynamic Government's efficient adaptation to a changing world and changing needs.

An often overlooked element of spending control is the transfer of the provision of some goods and services from the Federal government to the private sector. It has become increasingly clear that the government and the private sector should do what each does best. The Federal government should not provide goods and services that can be more effectively and more efficiently produced by the private sector. Moreover, government actions and policies often interfere with the proper function of the private sector. A major theme of the President's FY 1989 budget is regulatory relief and privatization. It is important to note that the strategy of privatization does not necessarily imply the elimination of goods and services now provided by the government. Rather, it would make private alternatives available. In this way, it ensures the production of the goods and services actually demanded by consumers, not those chosen by the government.

The Budget Process

While we have experienced success in reducing the budget deficit, reforming the tax code, and releasing resources for private use, the budget process itself has lapsed into disarray. Last year the budget process failed to provide us with an opportunity to decide many important budget matters on their merits. The failure occurred despite the submission of a timely budget proposal by the Administration. This is not responsible governance. The budget process should be reformed, root and branch. In his legislative message, President Reagan has proposed numerous detailed reforms to the budget process, including adoption of a line-item veto, the balanced budget amendment to the Constitution with a super-majority vote required for tax increases, a joint budget resolution to be signed by the President to set Congressional budget priorities, and enhanced Presidential rescission authority. To help us make further significant progress in reducing the budget deficit, the Congress should act on budget reform this year.

Conclusion

We enter 1988 with cautious optimism. While the dramatic decline in stock prices last fall has clouded the outlook, the economy continues to exhibit considerable forward momentum. Employment growth remains strong and inflation is under control even as the economy shifts over to export-led growth and more emphasis on investment. The current economic expansion--the longest on record during peacetime--is displaying few of the imbalances that have jeopardized other expansions. The extraordinary length of this expansion does not necessarily imply an impending downturn as some analysts suggest. Expansions do not die of old age; they have typically been aborted by erratic and inappropriate policy changes.

The continued restraint of government spending in the President's FY 1989 budget is an extension of the policies that have promoted strong, sustainable, noninflationary economic growth. In confronting the uncertain events that will evolve in the coming year, it is imperative for us to resist additional government involvement as a solution to short-run problems. Such involvement has been unsuccessful in the past and ultimately becomes part of the problem rather than part of the solution. I am sure that by working together the Administration and the Congress can provide a budget that consolidates our hard-fought gains on deficit reduction without sacrificing funding for the necessary and important functions of government.

Chart 1

SHARES OF TOTAL BUDGET OUTLAYS

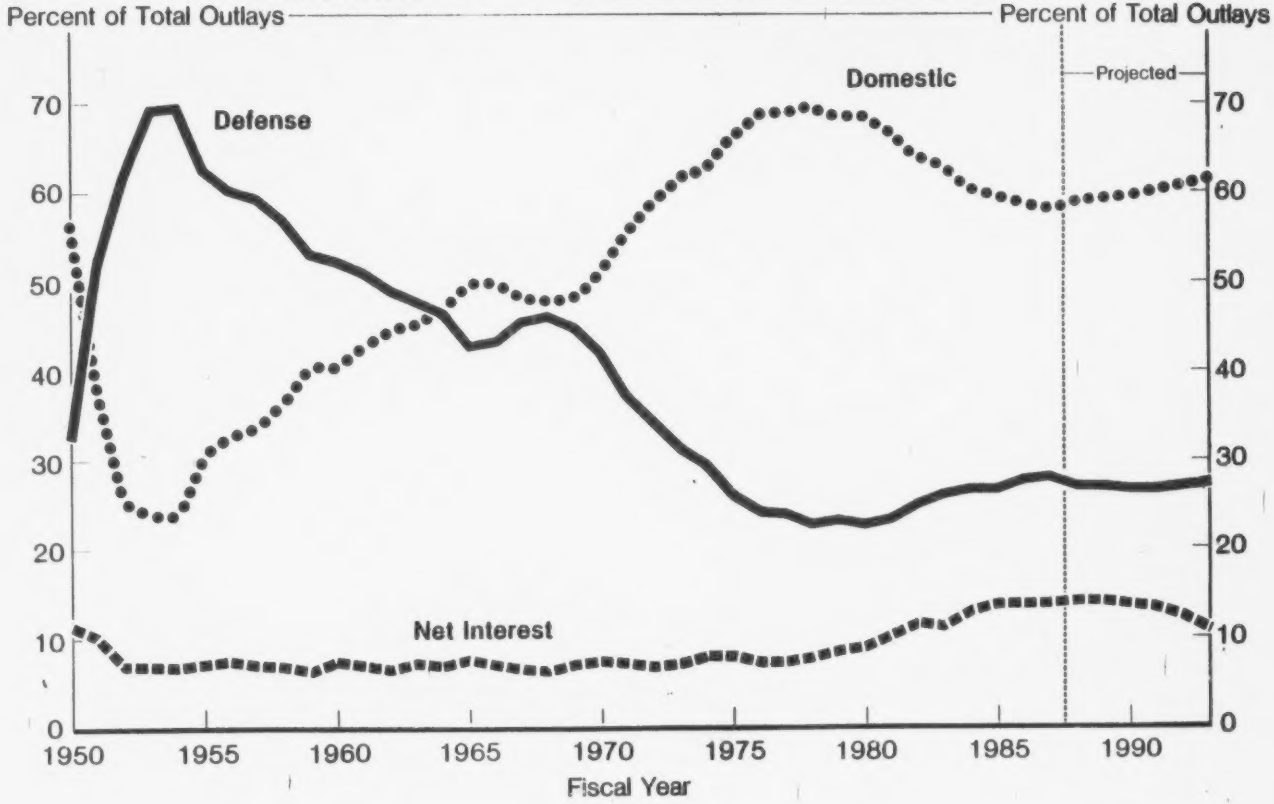


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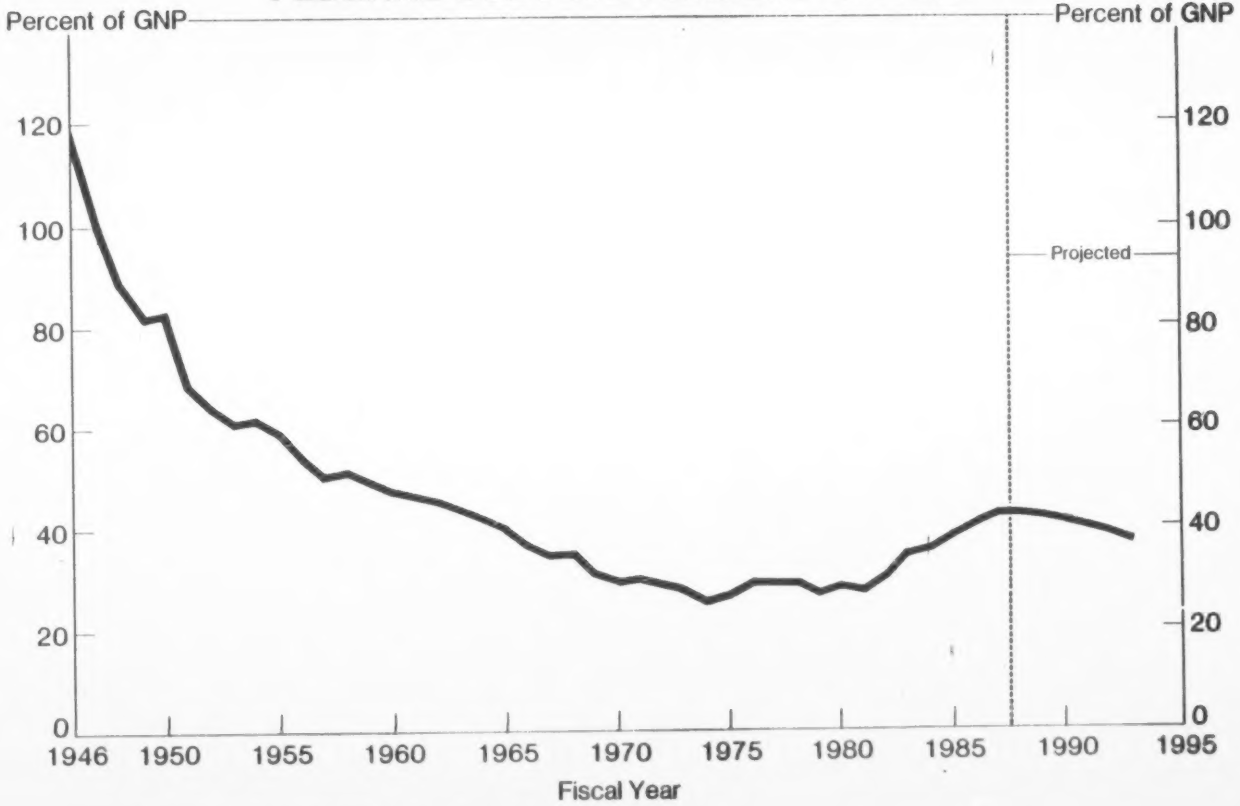
Chart 2

FEDERAL DEBT AS PERCENT OF GNP



Note: Debt held by the public, including the Federal Reserve.

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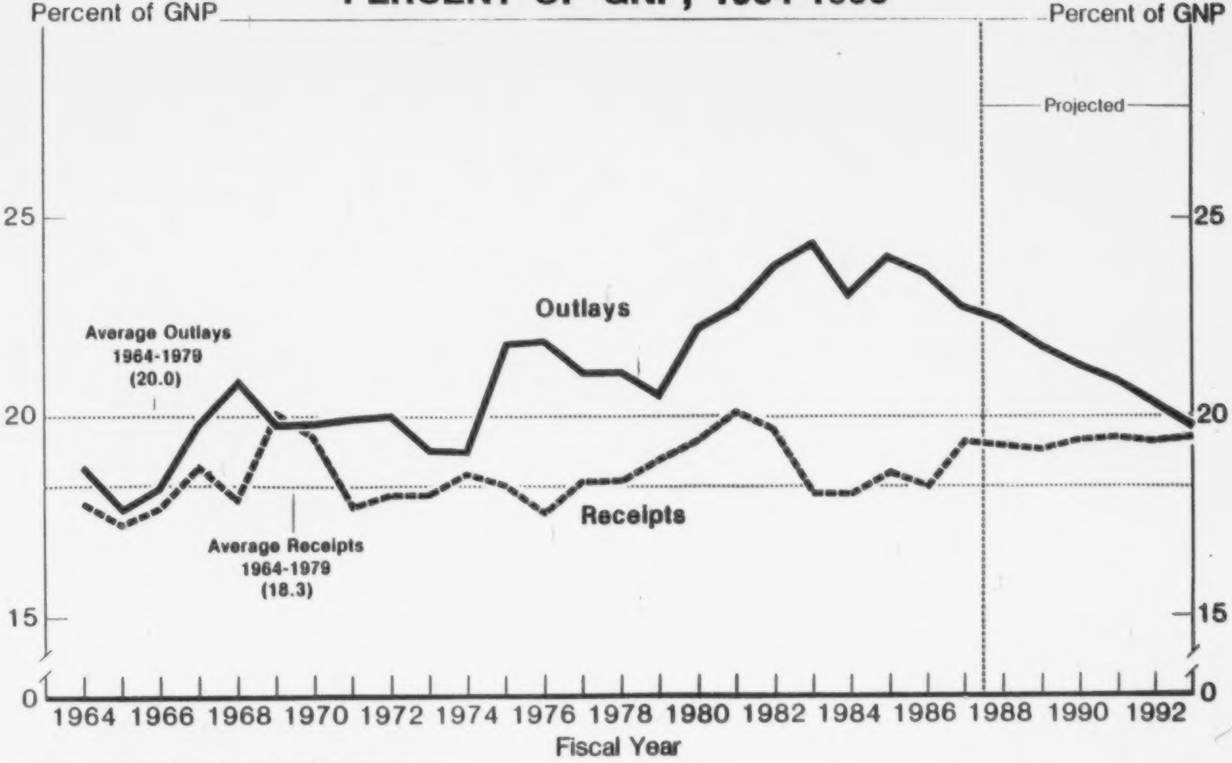
Chart 3

OUTLAYS AND RECEIPTS AS PERCENT OF GNP, 1964-1993



Note: Totals include off-budget receipts and outlays.
Data for 1988-1993 from FY 1989 Budget.

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HEARING PROCEDURE

Chairman STENNIS. Mr. Secretary, we appreciate the contribution you have made here. I am a believer in giving as many of the membership a chance to ask the questions they wish. We have important other matters, too, going on now, so I am going to pass up, temporarily, my chance to ask questions.

Gentlemen of the committee, we start out now under the 10-minute rule. If anybody wants to ask additional questions, of course, we will make room for it.

Senator Burdick, I will call on you, sir, under the 10-minute rule.

ASSET SALES

Senator BURDICK. Mr. Secretary, could you tell me how the budget treats asset sales?

I understand you have proposed to sell Farmers Home loans, the problem is that you sell them at a discount. What is the situation with regard to asset sales?

Secretary BAKER. Senator Burdick, we have some provisions for asset sales in the budget. We call for, pursuant to the budget agreement, sales of assets in compliance with the agreements arrived at in that Budget Summit Agreement. However, we also suggest that it would be good policy to go a little bit further than that and sell not just financial assets, but sell some real assets as well.

Senator BURDICK. What is the discount at which they are being sold?

Secretary BAKER. Sir, I am not sure I can give you the exact numbers.

Senator, I am advised that the face value of the financial assets is $12.0 billion, and they are being sold for $8.5 billion. It is $12.0 billion face, and $8.5 sales price for the financial assets. The real assets, of course, would be sold at our estimate of their fair market value.

Senator BURDICK. It doesn't generate much saving for the government, does it?

Secretary BAKER. It generates $8.5 billion, if you assume, Senator Burdick, that the assets aren't worth any more than that, and that is our best judgment as to what they are worth.

I said last year, on numerous occasions, as Chairman of the Federal Financing Bank, that the assets that we carry on the books at $155 billion are really not worth $155 billion.

We, in the administration, think that it is important that we conduct some sales of these financial assets for one reason, to determine exactly what their worth is to the American people.

Senator BURDICK. In other words, they are being sold at less than the face value.

Secretary BAKER. Yes, sir. They are not worth face value, so they are being sold at less than face value.

Senator BURDICK. How did we find ourselves in that position?

Secretary BAKER. We got ourselves in that position by extending the Federal Government's credit on a number of occasions, and across a wide range and array of programs, assuming that these notes that we would take in return for that credit were worth 100 cents on the dollar.

They are not worth 100 cents on the dollar either in the international portion of the portfolio or the domestic portion of the portfolio.

SITUATION IN AGRICULTURE

Senator BURDICK. What does your crystal ball show you in regard to agriculture?

Secretary BAKER. I am not sure I have a crystal ball, Senator, but it does appear to me that the agricultural sector is vastly improved over what it was a year ago. There are still some credit problems out there, but overall and generally speaking, we think that the agricultural sector is on its way back.

We have an energy sector that is still somewhat depressed in this country. The energy and the agricultural sectors were the two sectors of our economy that were in the worst shape, we think, last year. We see agriculture coming back somewhat.

Senator BURDICK. I certainly hope that you are correct. It is really a basic industry in this country.

Thank you, Mr. Chairman.

Chairman STENNIS. Thank you, Senator.

Senator Kasten.

Senator KASTEN. Mr. Chairman, thank you very much.

ECONOMIC EXPANSION

Mr. Secretary, first, I would like to compliment you on your leadership in terms of shaping an historic economic expansion.

As you pointed out in your statement, we are now in the 64th month of economic growth, which is the longest peacetime expansion ever. With this expansion, we have created millions of new jobs, reduced Federal spending as a proportion of the GNP, and your leadership, I believe, is key to this success.

I also think that it is important that we point out the opportunities created in this expansion have reached across income levels and across color lines. The unemployment rate for minorities is down. More people are now going to work in both industrial and manufacturing sectors, as well as service sectors.

In fact, last year, we did even better than the administration projected, which is also good news, that is a growth rate of just over 3 percent was projected, and we achieved an increase in GNP approaching 4 percent. That difference made a big difference in creating new jobs and helping contain the Federal deficit.

I want to commend you.

POSSIBILITY OF INCREASED TAXES

As we look to the future, this year there seems to be a consensus that taxes will not be raised to reduce the deficit. This year's budget seems to be less controversial, and I think we are going to be implementing its basic guidelines and the structures. My question to you, if we implemented most of the President's budget and if the economy grows as you are projecting at a reasonable rate, do you think that we are going to have to raise taxes in the out-years, in other words, in 1989, 1990, or

1991, and are we going to be able to work within the current basic tax structure?

Secretary BAKER. Senator Kasten, we have no reason to think that our estimates are not correct, and we really honestly think they are.

In past years, we have been accused of coming up here with rosy scenario forecasts. I might just say, for the record, that this has not really been the case. We have under-predicted in 4 years, and we over-predicted in only three. Last year we were low, as you know.

I hope that we can put aside this argument that we engage in almost every year that somehow our estimates are not accurate. I think there was a GAO study back in 1986 that said that there was no reason to think that either OMB or CBO estimates were that different from those of the private forecasters as to be consistently inaccurate.

Putting that aside for the moment, I don't see any need, provided the President's budget is enacted, to increase taxes. As I indicated in my opening remarks, even under the current services baseline, the deficit will continue to decline into the out-years. If the President's budget is enacted, of course, that deficit will decline even faster.

We do need to avoid a recession. We need to avoid higher unemployment. We need to avoid busting the Summit Budget Agreement by increased spending. In my opinion, we need to avoid raising taxes, if we are going to continue to enjoy economic growth.

If the President's budget is enacted, we will see the deficit decline to four-tenths of 1 percent of GNP in fiscal year 1993, and down to 2.1 percent in just a year or so. So I don't think that a tax increase is necessary.

INCREASE IN JOBS

Senator KASTEN. This year, you are projecting a growth rate of 2.4 percent. Do you have statistics or projections on how many jobs are going to be created next year, and any sense of the mix between manufacturing industry and service?

Secretary BAKER. No, sir, I do not have that. I would be delighted to get that for you.

Senator KASTEN. One of the things that I think we need to talk more about is the fact that the new jobs are not necessarily the low-pay service jobs. We are increasing in manufacturing. We are increasing across-the-board.

Secretary BAKER. I think I mention in my opening statement that manufacturing jobs have increased by 410,000 last year alone. Industrial production is up significantly. Our manufacturing sector is coming back and coming back strong. There can be no argument that the United States is not price competitive any longer as we are seeing significant gains in the manufacturing sector.

EFFECT OF TAX REFORM ACT OF 1986

Senator KASTEN. Mr. Secretary, as many taxpayers are finding out right now, as they start to work through their tax forms, the full benefit of the Tax Reform Act of 1986 was not fully implemented last year. People lost most of their deductions, but a number of people did not benefit from the incentives of lower rates.

Do you have any projections on the impact of the so-called "stagger" in the new tax law, and specifically what economic activities will lower rates encourage now that they will be fully implemented in this tax-year?

Secretary BAKER. Let me see if I understand your question, Senator.

Senator KASTEN. This year, they lost their deductions, but they didn't get the benefit of the lower rates.

Secretary BAKER. That is correct, the rates did not come all the way down.

EFFECT OF FUTURE DEDUCTIONS

Senator KASTEN. Next year, they will get the deductions and, theoretically, we are going to have an accelerated economic impact from that. Do you have any estimates or any assumptions that you are making based on the fact that we are losing "stagger"?

Secretary BAKER. We may not have incorporated that in our estimates as fully as we should have. We are not projecting much immediate economic growth resulting from the rate cuts, but this is because we are not sufficiently certain of the exact magnitude. We think it is quite possible that there will be even further increased growth as a result of the rate cuts.

Again in my opening remarks, I pointed out the fact that the $71 billion in deficit reduction that we enjoyed in fiscal year 1987 was partially attributable to the fact that we saw more revenues come in as a consequence of tax reform. There is no reason, in my opinion, to think that that possibility doesn't exist for calendar 1988 as well, since the rates will be reduced to their ultimate law.

UNITED STATES-CANADA FREE TRADE AGREEMENT

Senator KASTEN. I have one final question having to do with the United States-Canada Free Trade Agreement that you referred to in your prepared statement.

Basically, I am convinced that this is good for the country. But looking at a very narrow view for Wisconsin, the whole point of the free trade agreement is the breakdown of barriers, tariff and non- tariff. We are in the position where we see, in one particular industry which has an important impact on Wisconsin, the beer industry, the agreement is an important disappointment. As a matter of fact, it just fails.

You know, as well as I do, that the U.S. industry doesn't have a chance right now of competing in Canada with their listing practices, the high tariffs, the markups, and the way that they have beer marketed.

If you stop and look at the industry right now, you see Molson and O'Keefe coming in from the north, and you see Corona and Carta Blanca coming in from the south. Here we are without an ability to sell either north or south, but we are concerned about selling north right now.

I was encouraged somewhat by the recent GATT ruling against Canada on their barriers against alcohol, wine and beer, but the U.S. benefit from that ruling is still in doubt.

STATUS OF U.S. BEER INDUSTRY

What actions do you have in mind to free up Canada's market for the U.S. beer industry?

Secretary BAKER. Senator Kasten, to the extent that there is discrimination against the U.S. beer industry that amounts to an unfair trade practice, the rights and remedies of the beer industry in the United States, as they exist today, will continue to exist and will not be adversely affected by the Canadian Free Trade Agreement.

Let me say that we tried hard on beer, and we were disappointed that we were unsuccessful. We were quite successful, as you know, on wine. We would hope that somewhere down the line, after this agreement has been in force for a while, and its benefits have been recognized and enjoyed by both countries, that we would have some success in expanding it to include additional products and additional industries.

I hope, as you indicated in your opening remarks, that you and others will look at this agreement on a national basis, as opposed to a local district or State basis. I happen to believe that it is ~~an~~ historic agreement. It will establish the largest free trade area between the world's two largest trading partners.

I think, ultimately, historians will take its measure. I think that it is truly a continental agreement. We are disappointed that we couldn't get beer included, but we couldn't.

Senator KASTEN. We want to work with you on that.

Secretary BAKER. As you know, we have agreed with the leadership in the Congress that we will be working with the Congress in drafting the implementing legislation for the Canadian Free Trade Agreement. We will be discussing, I am sure, this and other matters. I know the Senator on your left has some interest in this area.

Chairman STENNIS. I am sorry, but your time is up.

Senator KASTEN. Thank you, Mr. Chairman.

Chairman STENNIS. Senator Johnston, we are operating under the 10-minute rule, and I call on you please.

Senator Johnston. Thank you, Mr. Chairman.

Welcome to the committee, Mr. Secretary.

BUDGET SUMMIT

I am glad, as the twilight on this administration lengthens, we can look forward to a final year of relative peace and harmony, where the results of our Budget Summit will be implemented. It was, indeed, now in retrospect, a pleasure to be on that Budget Summit. It wasn't so pleasurable at the time that we were there.

Would you agree with me that that Budget Summit would probably have not occurred but for the stock market crash?

Secretary BAKER. I couldn't disagree with that statement, Senator.

Senator JOHNSTON. It was our feeling that this was really the precipitating factor, and that but for that 500-point crash in the stock market, Gramm-Rudman-Hollings would have taken effect, there would have been a sequestration.

When you say in your statement that the budget process needs to be reformed root and branch, would you include the Gramm-Rudman-Hollings process as part of that reform?

Secretary BAKER. I am not sure I would, Senator Johnston. I think that the Gramm-Rudman-Hollings Amendment is one of the principal disciplines that we have to maintain the war against over-spending, if I can put it that way, and I think that it is very important.

We have made some suggestions with respect to the line-item veto. I was discussing earlier with the Chairman the possibility of biannual budgeting, as well as other reforms. We think that there are plenty of areas in which improvements can be made so that we avoid the kind of situation that we were confronted with this year where we received a great big 1,000-page piece of legislation, with just a very few hours to either approve it or disapprove it, or shut down the entire government. We really don't think that that is the way the people expect us to budget.

Senator JOHNSTON. I very much agree with you on that. Of course, it was out of this committee that this 1,000-page bill came, but I would suggest to you that we really had no alternative because we had to have the numbers from that Budget Summit to plug into our 302(b)s, certainly on defense and on foreign affairs, before we could put together a bill.

Secretary BAKER. I am not suggesting that it is the fault of this committee at all, Senator.

Senator JOHNSTON. What I am suggesting is that, to a large extent, it is the fault of the Gramm-Rudman-Hollings process, which tends to throw the whole year's work into the last few months. If we hadn't had to deal with that problem of the 302(b) allocations, we could have gotten out our appropriation bills much earlier in the year. We just simply had no choice but to put all of that in one bill at the last.

Secretary BAKER. May I just offer, Senator, without carrying this any further, that in the 7 years we have been here, we have never received 13 appropriation bills. Not in one of those years have we received 13 appropriation bills.

Senator JOHNSTON. It is also fair to say that in some of those years, you have wanted the bills put together in a CR. That is fair, isn't it?

Secretary BAKER. I think that that is probably fair to say, yes. But we probably would have preferred to get all the bills one way or another.

I don't think that you would argue with me that there are improvements that can be made in the budget process; I hope not.

FLAWED BUDGET PROCESS

Senator JOHNSTON. No, and I would certainly say that one of the ways is to reform Gramm-Rudman-Hollings. It seems to me basically flawed to assume that the budget deficit should come down on a certain amount every year, which you can preordain 5 years in advance, without reference to the state of the economy in that year. I think there are some years where you can go much below that, and some years when the targets cannot be met. The process is, therefore, very much flawed.

Secretary BAKER. Doesn't it provide for relief where the economy weakens? I think it does.

Senator JOHNSTON. Where the economy is in recession, I think, defined as being either real or projected two quarters of non-growth. Sometimes, you have a weak economy that cannot sustain growth with deep cuts in spending. For instance, if CBO is correct, you would have to cut some $40 or $41 billion in spending this year, and I don't think the economy could stand that.

Secretary BAKER. I think, though, Senator, without that discipline, I am not sure we would have gotten the Budget Summit Agreement.

I worry, frankly, that it is so much easier to raise taxes, not to advocate raising taxes but to actually raise them, than it is to raise spending. Thus, I think the Gramm-Rudman-Hollings law affords us some discipline that is badly needed. It is not perfect by a long shot.

SOCIAL SECURITY

Senator JOHNSTON. Let me ask you another question. On Social Security, the projections are that some years out when my kids, who are now working, are eligible to receive Social Security, that the Social Security System will be in serious deficit. Are you familiar with those projections?

Secretary BAKER. The Social Security agreement that was entered into in 1983 preserved the financial integrity of the system at least through 2025. There may be some questions on the part of some about what happens after 2025 or 2035.

Senator JOHNSTON. It is worse than that. It is not like 2025 is as far as you can see, and after that it is in question. It is very clearly going in serious deficit, I think, about 2025 or something like, which is when the baby-boomers retire.

Are you saying that it is too speculative, and we don't need to worry about that now?

Secretary BAKER. I guess what I am saying is, we have difficulty estimating 5 years out. The law requires that we project 5 years for budget purposes, and that is very difficult.

Senator JOHNSTON. We know how many people are living, what their ages are, and when they will retire.

Secretary BAKER. But there are some assumptions that have to be made in that calculation, Senator Johnston, that are very, very iffy. A change one way or the other, a slight change one way or the other, can make a big difference.

All I am saying is that the Social Security System is currently in one heck of a lot better shape than it was in 1981 and 1982, before we were able to get the Social Security Agreement, a bipartisan agreement of the top political leadership of both parties in this country in both legislative and executive branches. I think that was a success. I think we ought to see it as that, and at least accept the fact that the system is in good shape well into the next century.

DECLINE IN DOLLAR

Senator JOHNSTON. One final question. Would you agree with me that the dollar versus the yen has gone down about as far as it is going to go?

Secretary BAKER. I am not going to comment on the dollar, Senator, other than to say that we think any further decline of the dollar could be counter-productive as we indicated in our December 22 agreement with the other G-Seven nations.

Senator JOHNSTON. Is there anything that we can do about the four tigers of Asia who tend to put their currency and peg it to the dollar?

Secretary BAKER. Some of those countries are letting their exchange rates, or are beginning to let their exchange rates, more accurately reflect the underlying strength of their economies. We have been encouraging them to do that, and progress is being made in at least a couple of instances.

Senator JOHNSTON. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman STENNIS. Senator Domenici, we are operating now under the 10-minute rule.

Senator DOMENICI. Thank you very much, Mr. Chairman.

TAX ENHANCEMENT

Mr. Secretary, before we talk about the summit agreement and 2-year budgeting, and that kind of thing, could I ask you for a clarification with reference to the expectation for increased revenues resulting from IRS compliance efforts?

I don't quite understand what is expected this year on the revenue side from increased tax collections. What is the estimate of IRS compliance revenues in the President's budget, and then what is expected by way of additional IRS appropriations, if any, to achieve those revenues which is of very great importance to Senator DeConcini and me. On the Treasury-Postal Service Subcommittee, we have to know how much money we need for IRS and go beg the committee to make sure to get that for starters, or else we can't achieve the additional revenues.

Would you give us both the gross estimate of IRS compliance revenues and how much you think we need to provide for the IRS to reach the gross estimate, and I assume by subtracting the numbers that is the net estimate?

Secretary BAKER. You are talking about for this year?

Senator DOMENICI. For the budget year that you are testifying about.

Secretary BAKER. Fiscal year 1989?

Senator DOMENICI. Yes, sir. The $2.9 billion that was agreed to in the Summit Agreement has been achieved through the legislation that was enacted enforcing that agreement, and we need no new appropriations to achieve that.

Senator DOMENICI. The $2.9 billion, is there some windfall in that? I thought that we expected only $2 billion in our Summit Agreement. It seems to me that you have net revenues of $2.9 in this budget.

Secretary BAKER. No, sir, there is no windfall. I am looking at a copy of the Summit Agreement now that says: IRS compliance net, fiscal 1988, $1.6 billion, fiscal 1989, $2.9 billion.

Senator DOMENICI. The budget proposal for IRS compliance revenues in fiscal year 1989 is $2.9 billion. Did you just say that?

Secretary BAKER. I just said that.

Senator DOMENICI. You expect $2.9 billion?

Secretary BAKER. Yes, sir.

Senator DOMENICI. With no additional or enhanced appropriation for IRS. Is that correct?

Secretary BAKER. That is right.

Senator DOMENICI. Did we give you enough funding in fiscal year 1988 to arrive at these numbers?

Secretary BAKER. That is what I am told.

COMPETITIVENESS AND PRODUCTIVITY

Senator DOMENICI. Mr. Secretary, with reference to the President's budget, aside from meeting the targets under the Summit Agreement using OMB's economic assumptions, is there anything notable about the budget that, in your opinion, addresses the issue of competitiveness and productivity, and a changing of the American market?

I am impressed with some of the administration's proposals. I think the President has made some good choices to spend more money in research, more money in education and labor programs that have as their goal worker retraining, that is an adult retraining program of about $900 million.

I can go through the list, and as I see the increases, it seems to me that some choices have been made to spend money on the future instead of on past programs.

Secretary BAKER. That is correct, Senator Domenici.

NSF BUDGET

Senator DOMENICI. Was that intentional? As you sat around the budget discussions, was it an intentional decision, as you see it, to fund such things as the National Science Foundation with a significant increase, and a doubling of its budget in 5 years?

Secretary BAKER. Yes, sir, but that doesn't depart from the same effort made in the fiscal year 1988 budget. We had a similar emphasis in that budget. Last year, you will recall, the President sent a competitiveness proposal to the Hill, a very broad-based package of measures that he felt would make this Nation more competitive.

As I indicated in my opening remarks, we are becoming a great deal more competitive. Our manufacturing sector is coming back strongly. We are now price competitive with our major trading partners. We see our trade deficit improving substantially in volume terms.

But you are quite right when you say that the emphasis in this budget is really upon the future. We have tried, within the limitations of the Budget Summit Agreement, to direct the resources where we think they are needed.

Not all of it is international competitiveness. We have also significantly increased spending on AIDS. You have noted increases for education. We have additional job spending of about $1 billion to teach job skills to welfare recipients. We call for a significant increase to fight crime and drug abuse in the United States. We have more money, 43 percent over the 1988 level, for the homeless. But there is a concentration as well on areas that would make the United States more competitive internationally.

TWO-YEAR AGREEMENT ON BUDGETING

Senator **DOMENICI**. Mr. Secretary, with reference to the budget process, would you permit an observation on my part, and then I would appreciate your comments.

Secretary **BAKER**. Sure.

Senator **DOMENICI**. Frankly, I believe that those who assume the Summit Conference was a failure do not understand its real significance.

As I look at this year's actions of Congress, two very dramatic things happened in that summit that have to do with the budget process. One is, we have a 2-year agreement on numbers. I recall that you vividly pursued that in the Economic Summit Conference, and insisted that we have a 2-year budget.

Secondly, and most interesting to this Senator, three categories of expenditures were agreed upon with actual dollar numbers, not one as we have in the past. Defense spending was agreed upon. Foreign Assistance funding was agreed upon. The sum total of domestic spending was agreed upon.

I think what we have this year, even though defense is going to take a very, very substantial reduction, is within the domestic accounts of this government, an opportunity for confrontation on new initiatives and new funding versus old programs and old funding.

Secretary **BAKER**. Yes, sir.

Senator **DOMENICI**. There is nowhere else to go, as I see it, other than that one pot of money. You can't go to defense, and you can't go to foreign assistance, because they have been agreed upon. You can't borrow from them or take away from them. Is that how you understand the agreement?

Secretary **BAKER**. That is very understanding, Senator Domenici. Then, of course, as you recall, we had substantial discussions to get there.

To say it another way, I think we would agree that the Summit Agreement places both a floor and a cap on domestic discretionary, defense, and international spending.

BUDGET CAPS AND FLOORS

Senator **DOMENICI**. I believe, even though it is the end of this President's term, for observers of processs and those who understand it intimately as you do, that this is a dramatic change in that you don't move things around once the agreement is made between defense, foreign assistance, and domestic.

Now the appropriators will have to live within the floor and cap on domestic spending, and they can't look anywhere else. I think you ought to observe that. It is a dramatic change, and it will force priority decisions up here because there won't be someplace else to look for the money, only within the programs on the domestic side.

Secretary BAKER. I agree with that, Senator Domenici. Let me simply say that the executive branch fully intends to live with that. I think the fact that we were able to get a 2-year agreement between the legislative and executive branches of government with respect to the budget is, in and of itself, a significant achievement.

CANADIAN FREE TRADE AGREEMENT

Senator DOMENICI. Now, Mr. Secretary, I have a number of other questions that will wait for a second round, if there is one, but let me ask you about the Canadian Free Trade Agreement.

As you know, I have a very serious concern about the way uranium is treated in that agreement, but I am going to leave that alone for a minute. It is a four or five-State issue. But now I'll address for a moment provisions relating to the oil patch in that agreement.

Mr. Secretary, I believe you have a rare opportunity to get such things as the windfall profits tax repealed by the U.S. Congress because of this agreement, and let me explain to you why.

Frankly, your agreement says that we have a level playing field as our goal. It is my impression that we don't start off with a level playing field. They have much greater incentives in the oil patch than we do. I submit to you that you ought to look seriously at the disparity.

You ought to insist that Canada give you their entire portfolio of incentives and subsidies. I don't think we have seen those yet. I don't think that you had them when you wrapped this agreement up.

I believe that you could come to Congress on some issues, like the windfall profits tax, and you could suggest that to move in the direction of a level playing field, we ought to change some of the laws on oil patch, in particular, laws on taxation of windfall profits. I believe you will find some fertile ground for that where you didn't find it before, because the field is not level, it will not be level for a long time.

I regret to tell you that I disagree with your notion that we can continue to enforce the agreement under our trade laws. I believe there will be nothing enforced that you agreed to in this agreement. I don't believe that you can enforce it on beer. Because you indicated that you were unable to get anything in the negotiations, I don't think that you can expect enforcement.

I urge, on oil patch, that you move in that direction; find some areas of equalizing this unlevel playing field.

Secretary BAKER. When I say, enforce, Senator Domenici, I am talking about the countervailing and antidumping laws of the United States. They are in no way limited, or they are not limited adversely, in my opinion, by this agreement. So if there are subsidies, those things can be approached in the way that they can be approached today for relief by people in the United States who are injured.

We tried very hard to get some agreement on the elimination of subsidies by both countries, rather than the approach that was ultimately followed. We couldn't reach agreement there. Consequently, the free trade agreement does call for the two countries to spend the next 5 years seeking to establish a regime which will dispense with subsidies. I must say that there is, I think, genuine interest on the part of the Canadians in doing that.

Let me just say one final thing. I totally agree with your comments regarding the Windfall Profits Act. Then, of course, this administration is, has been and remains committed to seeking to obtain a repeal of that law.

Senator DOMENICI. Thank you, Mr. Chairman.

Chairman STENNIS. Thank you.

Senator Bumpers, that brings us to you, sir.

Senator BUMPERS. Thank you, Mr. Chairman.

PROJECTED GROWTH RATE IN SUMMIT CONFERENCE

Mr. Secretary, you point out in your statement that you anticipate the slowdown in the economy from last year's 3.9 percent to this year's 2.4 percent. What was the projected growth rate in the Summit Conference before we finally adopted that budget last fall?

Secretary BAKER. Senator Bumpers, I don't recall exactly, but I think that it was probably 3.5 percent. It was in that area.

Senator BUMPERS. I think that it is a little high. I think that it was closer, probably, to 3.2 percent.

Secretary BAKER. That may have been it.

Senator BUMPERS. My question is this. I must say, I spoke eloquently and long on the floor of the Senate about how little confidence I had in that package. I certainly had no confidence that that package would really reduce the budget deficit this year. Obviously, it has helped, or the deficit would be much higher.

Now you have seen the CBO projections, which bear out precisely what I was saying. Number one, the growth rate was off by 1 percent and there are several rules of thumb about what this means for the deficit. It may cost the Treasury anywhere from $17 billion to $20 billion.

CBO has come out firmly saying that package is not going to reduce the deficit from last year's $148 billion, but the deficit is actually going to go up by $9 billion this year.

I think, considering the volatility of the market, that CBO's pessimism is justified. Yesterday, it didn't look as though there was much apprehension in the market. But I think, underlying, there is still a great deal of concern there in the market.

If we say, for example, to America that we just miscalculated and, yes, indeed, the deficit is going to go up in 1988, and it is going to go up again in 1989, just as CBO projected, what kind of a message is that to Wall Street?

Secretary BAKER. We shouldn't say that because that is not what is going to happen.

Senator BUMPERS. Tell us what is going to happen.

DECLINE IN DEFICIT

Secretary BAKER. What is going to happen is what we have suggested is going to happen, that is, the deficit is going to continue to decline. It will decline even more rapidly if you pass the President's budget.

I don't think that we should accept CBO's doomsday scenario any more than we should have last year when they were wrong.

We had the same argument, Senator, last year when we came up here. We were told that our estimates were too rosy. They turned out to be not rosy enough. As I indicated before you got here, we have been here 7 years, and in 4 of those 7 years, we have under-predicted growth, while in three we have over-predicted. So we are doing pretty well.

This is a reasonable estimate we are presenting you. It is within the range of the private forecasters. It is only, I think, six-tenths of 1 percent higher than the Blue Chip Consensus. I would submit to you that CBO is going to be as wrong this year as they were last year.

Senator BUMPERS. The difference between CBO and you is simply the growth rate, is it not?

Secretary BAKER. It is interest rates and the growth rate. So far interest rates seem to be closer to what we have been projecting than those CBO has been projecting.

Senator BUMPERS. So we are just going to wait and see how it turns out?

Secretary BAKER. Every year, in the budget process, you have to wait and see. If you are projecting for the next year, you have to wait and see where that forecast comes out. We are reasonably sure, Senator Bumpers, that this is a reasonable forecast.

We have every expectation of achieving 2.4 percent real growth in 1988. We don't think that we are going to see a recession. We have every expectation, provided that we follow the right policies, that we don't bust the Budget Summit Agreement by overspending to increase the deficit, and that we don't burden the economy with a tax increase.

GROWTH RATE IN FIRST QUARTER OF 1988

Senator BUMPERS. What was the growth rate for the first quarter of this year?

Secretary BAKER. I don't think we have it yet. It is not out yet.

Senator BUMPERS. The growth rate is not out for October, November and December, that is the first quarter of the year. I am not talking about the calendar year.

Secretary BAKER. That would be the last quarter of calendar year 1987. Real GNP growth was around 4.5 percent, a pretty healthy rate.

Senator BUMPERS. Do you have any idea, or is there any indication of what it is going to be for the first quarter of 1988?

Secretary BAKER. No. We have suggested, Senator Bumpers, that you are going to see growth moderate fairly substantially in the first and second calendar quarters of 1988.

Senator BUMPERS. Mr. Secretary, I applaud your tenacity and your optimism, but I have heard a lot of that now for 7 years, and we have an additional $1.4 trillion debt. It seems to me that if we are really serious about trying to get the deficits under control, we are going to have to do more than we have done.

Nancy Kassebaum wrote a piece in the Post, and she was absolutely right. She said that by the time we achieve the kind of consensus we have to achieve around here in order to get anything done, it's too late to get anything done. I thought that this was about as well said as is anything I have heard on the deficits.

My problem has always been with the President's intractibility on taxes. I didn't vote for that 1981 tax cut. I thought that my second grade arithmetic teacher would be twirling in her grave to believe the arithmetic that was brought over here to justify that bill. I must say that my second grade arithmetic teacher would have been proud of me because the deficits turned out precisely the way I thought they were going to turn out.

I am not one of those gloom and doom persons, but the next President of the United States is going to be walking through a mine field on the deficits. I take it that you don't share that notion.

Secretary BAKER. No, sir, I really don't. I think Senator Kasten asked a question along those lines. If you would simply pass this President's budget, the deficit would decline to four-tenths of one percent of GNP by 1993, and to 2.6 percent of GNP in just a year or so.

I really don't agree with such a negative view of our accomplishments. I think the fact that we have enjoyed 64 months of sustained economic growth without inflation is a salutary achievement, not something that we ought to be bemoaning.

I must say, I think that we have this year a bipartisan agreement on the budget. You can say that it didn't go far enough. Some have said that. Senator Domenici and I worked very hard to try and move it further, and so did Chairman Stennis and others.

A lot of us who participated would have liked to have accomplished more deficit reduction. Nonetheless, what we achieved was substantial, $76 billion. Believe me, only about $5 to $8 billion of this could be characterized, in my view at least, as blue smoke and mirrors. This is significant deficit reduction.

Senator BUMPERS. Mr. Secretary, every time I hear about the 64 months of sustained economic growth, I always want to say, "You let me write $200 billion worth of hot checks a year, and I will show a good time, too."

Secretary BAKER. That is not what has brought it about.

Senator BUMPERS. Well, of course, that is a great big portion of it.

Secretary BAKER. We fundamentally disagree on that.

TAX INCREASES

Senator BUMPERS. Let me ask you this simple question. I had my staff do an analysis of the deficit because there is so much misleading talk about it. Not one single presidential candidate is addressing the issue. If

I were going to criticize anybody on your side or on my side, either one, the only difference is, our side says: "We won't rule out taxes." Any economist in this country with any reputation at all says that you are going to have to raise taxes at some point.

I wrote a little piece for the New York Times last fall saying that we ought to leave the "transition"tax rates for 1987 in effect for the ensuing 3 years, just the personal tax rates, which raises about $8 billion in additional revenue for this year, and $50 billion in additional revenue over a 3-year period.

One of the ten wealthiest people in this country called me that afternoon—it wasn't Sam Walton from my State either, incidentally—and said: "I just read this piece that you had in the New York Times this morning, and it makes so much sense to me."

This guy, when he died, he thought he was going to heaven with Ronald Reagan. He called me and he said: "I just read that piece in the New York Times, it makes such eminent good sense. You are not going to have any problem with that, are you?"

I said: "You might start with your friend down on Pennsylvania Avenue. Of course, I will have trouble with it. We won't be able to get it done." He said: "I can't believe that, it just makes such good sense." I said: "Well, that isn't what Congress is strong on, doing what makes sense."

Let me ask you this question. Of about 500 functions of government, let me just name seven of them, defense, Social Security, Medicare, Medicaid, interest on the debt, civil service pensions, and veterans programs.

People sit around the coffee shop and said: "Why don't they cut out all that wasteful spending? I say, just fund those seven programs and completely eliminate the rest. Then don't cut the spending for others, don't just cut spending for Congress and the CIA, the FBI and the court system, totally eliminate all spending for the rest of government, totally eliminate everything else, your and my salary, and in fiscal 1986 you would still have had a $56 billion deficit just funding those seven programs.

Secretary BAKER. When?

Senator BUMPERS. In fiscal 1986, and in fiscal 1987, the deficit, if you just funded those seven and totally eliminated the rest of government, you would still have a $38 billion deficit.

Everybody says, "if they would just cut that wasteful spending, we could balance the budget." That is just not true.

Last fall, when Nancy Kassebaum, Fritz Hollings, Jim Exon, and Dale Bumpers, some of us, put it on the line and said: "Let's hold the Social Security cost of living increase to 2 percent, and let's leave that 1987 tax rate in effect," the administration was opposed to that. As far as I was concerned that was a very substantive, sensible proposal that really would have dealt with the deficit.

Secretary BAKER. That is not just the administration, Senator. That proposal was considered in quite some detail in arriving at the Budget Summit Agreement. I think that it is fair to say that both sides had problems with it, not just the administration.

Chairman STENNIS. I am sorry, your time has expired.

Senator BUMPERS. We will meet here again next year and see who was right, Mr. Secretary.

Secretary BAKER. That is a deal.

Senator BUMPERS. I guess we won't meet here next year.

Secretary BAKER. If you do it before January 20, I will make a deal with you.

Chairman STENNIS. Senator Specter, we turn to you now under the 10-minute rule.

Senator SPECTER. Thank you, Mr. Chairman.

Mr. Secretary, I hope that we do meet here again next year. Senator Bumpers and I will be here, and I, for one, am hopeful that you will be here.

I join my colleagues in welcoming you here. I want to congratulate you on, so far, 7 years of exemplary service in top administration positions, and to restate my hope that you will be the Secretary of the Treasury again next year to discuss some of these subjects with us. They doubtless will not go away.

FOREIGN TRADE AND FIREARMS ENFORCEMENT

In the 10 minutes that I have allotted, I would like to take up two subjects with you, the subject of foreign trade, and the subject of enforcement of firearms which comes under the Department of the Treasury.

Last year, when you were here, Mr. Secretary, I asked you a question about some bill language, which you had not been personally familiar with at that time. I would like to repeat that language today and ask you what progress, if any, has been made on this important subject. Last year, when you appeared before the Appropriations Committee, I called your attention to this language.

"In light of increased foreign trade deficits and unemployment in import sensitive industries, the committee directs the Treasury Department to instruct U.S. representatives to the multilateral development banks and to the International Monetary Fund to oppose and to vote against loans which would subsidize development of export industries in countries which receive loans from these institutions, which are engaged in dumping or other unfair trade practices with the United States."

My question to you, Mr. Secretary, what progress, if any, has been made on that important subject in the intervening year since you appeared before the Appropriations Committee?

Secretary BAKER. Senator, let me say, on a couple of the assumptions on the question, you and I, as you know, disagree.

I think that we have been creating jobs even in import sensitive industries. As I indicated in my opening remarks, as far as the trade numbers are concerned, our manufacturing sector is doing extremely well, and our trade deficit is declining in volume terms.

We instruct our representatives at the multilateral institutions to vote against loans to countries for the purpose of creating commodities that are in oversupply. Beyond that, we do not specifically instruct our representatives at the international financial institutions.

TRADE DEFICIT

Senator SPECTER. Mr. Secretary, I don't think that you really come to grips with the issue when you talk about creating jobs or lowering the trade deficit. I think that much more needs to be done on that subject.

A question, which I have pursued with some frequency being from a State like Pennsylvania which has lost many jobs to unfair foreign steel imports and unfair coal imports, is the example of a Pennsylvania steelworker paying taxes to the Federal Treasury, which then makes money available to the World Bank or to the International Monetary Fund, which then loans money to Brazil, which then subsidizes steel, which then takes away the job of the Pennsylvania steelworker and he can't pay any more taxes.

So it seems to me that there is a real need to do more than deal, as you say, with commodities which are in oversupply. The direction which this committee has made to the Treasury Department, to the extent that any direction is meaningful, and I realize that executive enforcement is a world unto its own, really calls for a tougher stand, where we just don't want our Federal money—this committee doesn't want our Federal money to be used to help subsidize imports, which come into this country, which take away U.S. jobs.

Secretary BAKER. Senator, I understand that. My answer to that would be that jobs in the steel industry have increased over the course of the past year rather rapidly and are continuing to increase. The steel industry itself, I think, is in better shape than it has been for many, many years. I believe that to be a consequence of the improvement in the trade deficit.

We live in an interdependent world. We have to trade as a nation with other countries. Other nations must be able to trade with us if we are to prosper and if they are to prosper. I know that this is not a politically appealing argument to you.

Senator SPECTER. I am not talking about what is politically appealing. I am really trying to talk about what is fair. There is a need to do more, I think. There are still too many steelworkers unemployed in Pennsylvania. When we use our Federal funds to stimulate countries like Brazil, which subsidizes its steel industry, I just think that that is unfair.

Let's be specific about it, Mr. Secretary, do you think that it is fair for Brazil to take away U.S. jobs by subsidizing its steel industry with funds that come from the U.S. Treasury and, in turn, from Pennsylvania steelworkers' taxes?

Secretary BAKER. No, if, indeed, U.S. jobs are being taken away. I do think that it is important that we be players, Senator, on the world economic scene, that we participate vigorously in the international financial institutions. I recognize that these institutions have no constituency in the United States. As one who has participated in the past in politics, I am well aware of that.

I don't think that you can say: You can't make loans for that purpose. Then Congressman X from District Y, which engages in some other production, says: You can't make loans for that purpose, and you can't make loans for this purpose, and you can't make loans for that purpose. The result would be that we would opt out of these organizations, and I think that would be to the detriment of the United States.

We are doing a great deal to further job creation in the steel industry today. We are price competitive around the world. We are selling steel to Japan, not a lot. I didn't think I would see that day as long as I was in this job.

I think we have to recognize that we live in an increasingly interdependent world, and we must be players.

Senator SPECTER. I agree with being a player, and I agree with the importance of trade.

You will be before the Foreign Operations Subcommittee again, Mr. Secretary, this year, whether or not you are reappointed next year by a Republican President, and what I would like to do in the interim, between today and the day that occurs, is to have my staff work with your staff on the specifics.

We can discuss it again at that time, perhaps in 2 months, when you come before the subcommittee. I find these discussions very helpful when the Secretary's attention is attracted specifically, and we can deal with the specifics.

Secretary BAKER. I will be glad to do that, Senator Specter.

Let me also say that I would welcome an in-depth review by your staff and mine on the question of how many of the myriad of loans made by those institutions would be objectionable to you. In other words, what would the percentage be?

Senator SPECTER. Fine, we will deal with the specifics. What this committee does or what this Senator would like to see done, to the extent that it can influence administration policy, I think that would be useful.

Secretary BAKER. I would be delighted to do that.

FIREARMS CONTROL

Senator SPECTER. In the 2 minutes I have left, Mr. Secretary, I would like to turn to the Treasury action on the Bureau of Alcohol, Tobacco and Firearms, which has the enforcement responsibility of legislation, which we passed in 1984 as the career criminal bill—I authored based on my experience as district attorney of Philadelphia—which was subsequently amended and makes it a Federal offense for someone found in possession of a firearm who has three or more convictions, including robbery, burglary, or drug-related offenses to get a mandatory sentence of 15 years to life.

What I would like to do, since we are not going to have time for any exchange within the time limits that I have, is to make available to you some letters, which I have written to Senator DeConcini, who is the chairman of the subcommittee, dated July 28, 1987, dealing with the impact of the Armed Career Criminal Bill on narcotics, and the letter from the Director of the Bureau of Alcohol, Tobacco and Firearm, Mr. Higgins, which summarizes the effectiveness of this kind of an approach on drugs.

I would call these to your attention because of the concern I have that there may be as many as 200 positions removed from the Repeat Offender Program. I also call to your attention, and perhaps you are aware of the Project Achilles Report, Mr. Secretary, so that a focus can be given at the highest level, at the Secretary's level, to retaining these positions and to utilize the $10 million, which was appropriated specially last year, because of the effectiveness of this program.

My time is up, when I asked the question, at the end of it, you are on somebody's time. But I would like your sense of the importance of this important enforcement mechanism and, hopefully, if I can get it, your assurance that positions will not be cut, but increased in the next fiscal year.

FIREARMS ENFORCEMENT PROGRAM

Secretary BAKER. The reason there has been a reduction in the fiscal year 1989 budget, Senator Specter, is that we are spending an ever increasing amount on the firearms enforcement program. I think we see a 31-percent increase over the fiscal year 1987 levels on firearm-related cases. We will recommend almost 4,900 suspects for prosecution, which is an 18 percent increase over last year's level. Efforts in the firearm compliance program last year increased by 66 percent over planned levels.

We share the general philosophy that is behind your proposal and your suggestion. It is a matter of funds. It is a matter of meeting the requirement of the Budget Summit Agreement, and meeting the budget totals. It is for that reason that we have seen this reduction in the number of FTEs.

I would be delighted to look at that. As you have indicated, I will be before you again. Before then, I will take a specific look at it. I haven't had a chance to do that beyond approving a general budget. We will have, as you know, over 153,000 FTEs in the Department of the Treasury in fiscal year 1989, and this reduces that 153,000 by only 200.

Chairman STENNIS. Gentlemen, I am sorry, your time is up.

CORRESPONDENCE

Senator SPECTER. I would just ask, Mr. Chairman, that these letters be made a part of the record, the ones that I am turning over to the Secretary.

Chairman STENNIS. Without objection, they will be admitted in the record.

[The letters submitted by Senator Specter follow:]

The Honorable Dennis DeConcini
Chairman, Appropriations Subcommittee on
Treasury, Postal Service and General
Government
U.S. Senate
Washington, D.C. 20510

Dear Dennis:

As the Subcommittee prepares to consider the Fiscal Year 1988 Appropriations Bill, I write to bring the Armed Career Criminal Program to your attention and urge you to include sufficient program funding in the bill.

The Armed Career Criminal Act, signed into law in 1984 and expanded by the Anti-Drug Abuse Act of 1986, provides mandatory sentences for certain violent repeat offenders who carry firearms. The Bureau of Alcohol, Tobacco and Firearms (BATF), given its jurisdiction over firearms laws, has a unique opportunity to impact on violent repeat offenders. The Bureau has implemented an Armed Career Criminal program in 18 of its 22 districts nationwide. The initial success of this program, as an additional element of the Bureau's entire firearms activity, has greatly exceeded expectations.

The conviction rate under this program exceeds 98 percent. In 1986, the Bureau obtained 44 convictions, totaling 665 years in enhanced sentences. Currently, 110 cases are being processed for adjudication. The Bureau, however, has not been able to implement the Armed Career Criminal program at a staffing level which the pilot program dictates, given its initial success rate.

Accordingly, I request that $15 million be appropriated to enhance BATF's Armed Career Criminal program, which would fund an additional 250 positions:

-- 150 special agents assigned to the program;

-- 75 compliance inspectors, who obtain leads from firearms dealers and ensure the integrity of the firearms tracking program; and

-- 25 support personnel.

Under this enhanced career criminal program, hundreds of convictions of violent offenders with enhanced penalties are expected.

In addition, I support Section 527 of the Treasury and Postal appropriation bill now pending before the Full House Appropriations Committee. This section provides for the commencement of a program to upgrade cobalt metal held in the National Defense Stockpile utilizing Stockpile Transaction Fund monies, as authorized. Studies by the American Society for Metals found that roughly 80% of our cobalt was "technologically obsolete," and could not be utilized for critical defense and industrial requirements. High purity cobalt is essential to the production of superalloys (jet engines) and cemented carbides (cutting tools, mining drill bits, etc.), and numerous direct military applications. We must plan for the future by commencing an upgrading program now to begin the time-consuming process of converting U.S. reserves of deficient cobalt to the highest purity standards for critical defense and industrial requirements.

Thank you for your consideration of this request.

My best.

Sincerely,

Arlen Specter

United States Senate
WASHINGTON, DC 20510

December 3, 1987

The Honorable Dennis DeConcini
Chairman
Appropriations Subcommittee on Treasury,
Postal Service and General Government
U.S. Senate
Washington, D.C. 20510

Dear Dennis:

Thank you for your letter in response to my request for increased funding in the Fiscal Year 1988 Treasury, Postal Service and General Government Appropriations Bill for the Armed Career Criminal Program implemented by the Bureau of Alcohol, Tobacco and Firearms (BATF). I appreciate your support for this important program and am pleased that the full committee included an additional $10 million in FY 1988.

I hope that you will continue to support the additional funding for the Armed Career Criminal Program in conference, and I urge the conferees to recede to the Senate position. As you know, the ultimate success of this program depends on adequate funding. These additional funds will enable the program, which has a conviction rate of 98 percent, to increase its staff by 200. As a result, the Bureau will have the necessary resources to obtain even more convictions of these hardened criminals in the years to come.

Thank you for your consideration of this request, and I look forward to continuing to work with you on this and other matters of mutual interest.

My best.

Sincerely,

Arlen Specter

AS/jc

DEPARTMENT OF THE TREASURY
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS
WASHINGTON, D.C. 20226

OFFICE OF
THE DIRECTOR

October 16, 1987

Honorable Arlen Specter
United States Senate
Washington, DC 20510

Dear Senator Specter:

The purpose of this letter is to provide you with updated information regarding the accomplishments of the Bureau of Alcohol, Tobacco and Firearms (ATF) in support of the provisions of the Armed Career Criminal Act of 1984 and the 1986 amendments to the Gun Control Act of 1968.

As you are aware, ATF is utilizing the task force concept in cities throughout the United States to combat the armed career criminal problem. The task forces coordinate Federal, State, and local law enforcement efforts against the armed career criminal. This approach has enabled the utilization of resources from numerous agencies at a minimal cost to the Government to remove the armed career criminal from the street. These task forces were started in 1985 in four cities. Since then, staffing and budget increases have enabled us to increase the number of task force cities to seven. We recently requested additional positions to further enhance the enforcement of this program.

In addition to our formal task forces, ATF has initiated Project Achilles on a nationwide basis. Project Achilles is designed to identify, investigate, and prosecute armed career criminals who qualify for the mandatory and/or enhanced sentencing provisions under 18 U.S.C. sections 924(c) and 924(e). This project is in operation in the majority of our law enforcement offices.

Since April 1, 1986, the task force and Project Achilles efforts have resulted in convictions with enhanced sentencing for 72 armed career criminals. These criminals have been removed from our society for periods of 15 to 30 years. One defendant was given a life term. The total number of prison years, excluding the life sentence, is 1,206 years. The average sentence thus far has been 16 years. During this same period, ATF has obtained mandatory sentencing under 18 U.S.C. section 924(c) on 15 armed narcotics traffickers.

The task force approach and Project Achilles concept have proven to be cost effective ways to utilize the provisions of the Armed Career Criminal Act and the amended Gun Control Act. I believe with proper funding and resources ATF can continue to have a very positive impact on the crime problem by removing the armed career criminals and narcotics traffickers from our streets.

The Armed Career Criminal Act of 1984 has been given a warm and enthusiastic reception by members of the law enforcement community and prosecutors across the country. Thanks to the foresight which you and other legislators exhibited, law enforcement has been given an extremely effective tool to work with. I believe as the years pass you will look upon this Act with a great deal of pride.

We hope you will find the above useful and informative. If we may be of assistance, please contact us.

Sincerely yours,

Stephen E. Higgins
Director

DEPARTMENT OF THE TREASURY
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS
WASHINGTON, D.C. 20226

DIRECTOR

FEB 26 1988

Senator Arlen Specter
United States Senate
Washington, DC 20510

Dear Senator Specter:

Per your recent request, the following information is provided regarding the Bureau of Alcohol, Tobacco and Firearms repeat offender program.

	FY 1987	FY 1988(1st Qtr.)
18 USC 924(c) defendants	164	111
18 USC 924(e) defendants	301	78
Total	465	189
Grand Total (FY 87 & 1st Qtr. FY 88)		654

Additionally, during FY 87 and the first quarter of FY 88, 2,486 repeat offender suspects, all of whom had prior felony convictions, were charged with Federal firearms law violations. Our overall conviction rate in those firearms cases adjudicated in FY 87 was 96.3.

Sentences for violations of 18 USC 924(c) and 924(e) averaged 12 years in a recent study of 127 convictions.

We hope this information is useful to you. Should you need further information, please contact us.

Sincerely yours,

Stephen E. Higgins
Director

TRUST FUNDS

Senator Nickles, we are glad you are here. We are applying the 10-minute rule.

Senator NICKLES. Thank you, Mr. Chairman.

Mr. Secretary, welcome.

I am one of the few Senators, I would imagine, that reads the Treasury monthly reports that come from your department that give us the income and outgo, the deficits, the account balances, and so forth.

On the general subject of trust funds that I visited with you over the past year or so, I think there is a real misconception that a lot of people have. Would you agree with me that there is misconception that we have a lot of general trust funds, whether it be civil service retirement, Social Security, land and water conservation, highways, or airports.

Is it correct that actually the United States doesn't have any separate account for any of those funds that I have mentioned where funds are actually deposited?

Secretary BAKER. That is correct.

Senator NICKLES. Do you have an idea of how much the surplus of those earmarked funds is in next year's budget? I am not trying to make it a leading question.

Secretary BAKER. If the point you are making is that if you took those trust funds off budget, would you seriously increase the size of the Federal deficit, the answer is, yes, you would.

Senator NICKLES. The size of it is $112 billion. That figure came from Mr. Miller, and it surprised this Senator, and perhaps a lot of Senators.

Secretary BAKER. The surplus figure?

Senator NICKLES. The surplus of each one of the trust funds—I think Social Security was $45 billion, the Medicare Trust Fund was another almost $20, and then the retirement trust funds, the highways, and so on—they all added up to $112 billion. It means that if you took those out, the net operating deficit for next year would be $242 billion. That really concerns me.

I am one who has not been blasting the administration so much. I personally think that Congress is probably more responsible for the deficit than the administration, although there is plenty of guilt to go around. But without looking at people to cast blame and talk about that, we really have to be working our way out of the problem.

This administration will be gone by this time next year, but the problems are still going to be here. If you take those trust funds, assuming that civil service has obligations that it should be funding, and it is probably under-funding, the same thing with Social Security, the same thing for highways and airports, and most any other account, those future obligations are there.

If we have a net operating deficit of $242 billion, in other words, for our on-going operations, it really concerns this Senator. I would like, for one, to have people be more aware of it and, two, to be working toward constructively trying to reduce it.

I am not talking about massive tax increases, but I am trying to look at the problem and say, let's work together in a bipartisan administration/congressional cooperation to see if we can't make some headway.

In your statement, you mentioned a deficit of $221, and last year it was $150. That is a $71 billion reduction, and is the most significant reduction in history. Then when you look at it, the way a lot of it was reduced was by increases in some of these funds. Next year, it is estimated to go down somewhat, but the Social Security surplus goes from about $20 to $45, so much of that is caused by the increase in Social Security taxes.

I would like to see some real reduction besides just the increase in payroll taxes that I know are going to have a real burden on them in the year 2010 or the year 2020. Do you have any comment on that?

Secretary BAKER. That suggestion has been made from time to time, Senator Nickles, that we take the trust funds out of the unified budget. The point you make is a valid one, it would tend to exacerbate the deficit numbers.

I don't think that it is a good idea. I think that the U.S. economy is the U.S. economy. The funding mechanisms for those trust funds are every bit a tax and charge against the economy regardless of whether they are placed on or off budget.

Those are funds that are held by the United States in trust. I don't think that it is inappropriate to continue to compute the deficit the way we have over the course of the past quite a few years.

Senator NICKLES. I wasn't saying that I thought we should "separate them," although I know, from my private sector past, I used to operate a pension fund, and we put in a certain percentage of employees' funds, and that was in a separate account. Even if the business went bankrupt, the employees or individuals would have some funds available. We don't have that.

I think a lot of people have the misconception, that is, they have a Social Security Fund, even if we have real deficit problems, the Social Security money is still there, or the highway money is still there.

Secretary BAKER. Senator Nickles, I don't think that there is any question but that the legislative and executive branches of the U.S. Government, regardless of who controls them in the future, are going to hold inviolate the Social Security Trust Funds, and for that matter, the other trust funds.

I don't think there has ever been an instance where those funds have been misapplied without restitution having promptly been made. We have adopted the policy over the last 2 years down at Treasury that we are not going to go into the trust funds, to avoid default or anything else. We are not faced with that right now because we have a debt limit increase that goes to May of 1989.

I don't really think that that is a risk, and I don't think that the American people think that their government is going to misapply or misuse those trust funds.

Senator NICKLES. I am saying that the real risk is that a lot of people assume that we have a deficit of $130 billion when really the net operating debt, excluding trust funds, Social Security, et cetera, is much, much greater, almost double.

It bothers me, and I would like to work, maybe, if nothing else, on an educational basis, to let people be more aware of the problem, because we are spending for consumable items about $200 billion more than we are taking in. I would hope that maybe we would get more responsible.

At the same time, I see this administration, to some extent through catastrophic insurance programs that can be enormously expensive, not just in the beginning years but the out-years, and other programs that will only exacerbate the problem in the future.

Again, it may be more educational than anything else. I realize the games that can be played with numbers, but I really think that there is a misconception of what is going on. I would hope that in your offices, as Secretary of the Treasury, you would help lead some of that education.

Secretary BAKER. We have taken one step in that direction by making it clear over the past couple of years that we would not use trust funds to avoid a default or a violation of the statute establishing Federal debt limit, Senator, and that is one reason we did that.

To the extent that doing what you suggest would increase the discipline and motivation to limit spending, I think that it could be a very salutary idea.

Senator NICKLES. I thank you very much.

Thank you, Mr. Chairman.

Chairman STENNIS. Thank you.

INCREASE IN FEDERAL DEBT

Mr. Secretary, these matters here about the great increase in the Federal debt, they bother many of us. Maybe I am one of the chief mourners, and I don't understand this. I want you to explain it.

Secretary Baker, the Congressional Budget Office has projected that between 1981 and 1993 the gross Federal debt will have quadrupled, going from $1 trillion to $4 trillion. Assuming for the moment that the CBO figures are correct, would you please give us your considered opinion as to what the economic implications would be for the national economy if this were to come about?

Secretary BAKER. Mr. Chairman, first of all, the $4 trillion figure that you mention includes money which the Federal Government owes to itself. It includes trust fund money, the money that Senator Nickles was just talking about. Excluding that, the Federal debt that is held by the public is expected to rise to $2.4 trillion by fiscal year 1993.

An increase in debt is not a development about which this administration or the Congress can be very happy. The fact of the matter, though, is that we continue to fund it. We continue to have little problem, if any at all, in selling securities of the United States in competitive markets at competitive rates. We normally see our auctions more than 200 to 300 percent covered by tenders.

There are some risks in growth of debt of this magnitude, but I think that they tend to be overstated. I think, to some extent, that these overstated risks are a consequence of the fact that we are moving into 1988, which happens to be an election year.

The economy has done very well in most respects, but the important thing, I think, is demonstrated by the charts that I have attached to my written statement which show that the debt as a share of GNP, in fact, is beginning to decline. It has flattened out and is beginning to decline.

If the President's budget is enacted, the public debt of the United States would represent 43 percent of our gross national product. We have a gross national product in the neighborhood of $4.3 to $4.5 trillion, and it is going to continue to grow, and that is one of the reasons why our national debt as a percentage of GNP will be declining.

The public debt has been as high as 100 percent of GNP as recently as the end of World War II. As recently as 1961, the public debt of the United States was 46 percent of GNP, higher than it is today.

We are not pleased by that growth in debt, but we are pleased by the fact that it has flattened out and it is going to begin to decline as a percentage of GNP.

U.S. FOREIGN INDEBTEDNESS

Chairman STENNIS. I have just one more question here related to the one that I have asked.

In 1981 our Nation was the world's largest creditor, the rest of the world owed us over $140 billion. By 1986, the United States had become the world's largest debtor, owing over $400 billion to foreigners. Some believe that the 1989 foreign indebtedness will have risen to $575 billion.

Please tell us what the implications for our country's future will be if this pattern continues like it has to date?

Secretary BAKER. Let me say that that particular problem is the reason that we must continue to work hard to reduce the trade deficit. But again, that deficit is declining in volume terms and, in fact, over the last 2 months we have seen some decline in nominal terms.

We ought to keep a few things in mind when we talk about the United States as the world's largest debtor nation—as some people are fond of saying, larger even than Mexico, Brazil, and Argentina combined. I think the appropriate way to look at that debt is, again, as a percentage of the GNP, not in nominal dollars. After all, we have a GNP of $4.3 to $4.5 trillion.

As a percentage of GNP, the external debt owed by the United States is only 6 percent, whereas the debt of Mexico is 80 percent, the debt of Brazil is 40 percent, and the debt of Argentina is a similar percentage of their GNP, 30 percent. Mr. Chairman, of foreign holdings in the United States is in the form of equity. That equity represents jobs, it creates output, it creates technology. It is foreign ownership of factories that employ American workers, as well as foreign holdings in the United States stock market.

Unlike other major debtor nations, claims against the United States are denominated in dollars. Because we owe this debt in our own currency, we do not take an exchange-rate risk that other countries might take.

The last point I would make on this very important issue is that the numbers you have recited are basically computed on the basis of book value, as opposed to market value. Most U.S. investments abroad were made many years ago, and their book value is lower than some recent investments in the United States that were made much more recently and, therefore, carry a higher nominal dollar amount.

Chairman STENNIS. Thank you, sir.

Senator, we are glad you got back and we will recognize you now. We are still having the 10-minute rule.

Senator Grassley.

Senator GRASSLEY. Mr. Secretary, if I ask you any questions that you have already answered—because I have been in and out and I haven't been able to keep track of all the dialog going on—just simply say that you answered that question for so-and-so, and I will be happy to read the record.

REVENUE NEUTRAL LEGISLATION

I would like to have you look, in isolation, at the 1986 tax bill, but because of your estimate of revenue coming in for the present budget, you had to take that into consideration plus all the other revenue. One of the principals of the 1986 tax bill was that it should be revenue neutral.

Do we know enough about it, and if you do, can you tell us if in fact it looks like after a year of operation that the 1986 tax bill, considering the reduction of revenue on one side of the ledger and increase of revenue on the other side, is bringing in the revenue that we anticipated it would, or more or less?

Secretary BAKER. I don't think we need be concerned that it will bring in less, Senator Grassley. Therefore, I think we can, without absolutely knowing at this early stage, be comforted in the view that it is, in all likelihood, at least revenue neutral. It may, in fact, gain revenue. Our experience last year was that it did gain revenue.

In answer to a prior question, I think I said that with tax rates coming down this year to their lowest scheduled level, it would not be unreasonable, in my personal opinion, to think that we might see even larger revenues this year than we had anticipated.

INVESTMENT TAX CREDIT

Senator GRASSLEY. That is from the general macroeconomic impact of the legislation. Would there be any area like, for instance, in the reduction or the doing away with the investment tax credit, which was a large source of increased revenues, or the changing of the depreciation schedule. Those large areas, have they produced the revenue that we anticipated, or did we underestimate or overestimate any areas?

Secretary BAKER. I can't answer specifically with respect to either of those. I can have some research done, and I will be happy to supply you with some numbers.

Let me say this: repeal of the investment tax credit was one of the biggest fights we had in the negotiation of tax reform. A lot of people were predicting that taking this step would lead to the end of western civilization as we knew it, that our industries would not be able to compete, that we would not be able to modernize, that we would not have capital investment, etc. These have turned out absolutely not to be true. If anything, the manufacturing sector of this country is in much better shape today than it was before tax reform.

That is due in part at least to the impact of some other considerations, such as the fact that we are more price competitive around the world, and so forth.

Senator GRASSLEY. If you are going to submit something for the record, I would suggest—besides those two that I offered for your comments on—maybe the ten major areas that we estimated increased revenue because of change in the tax policy, and give me the estimates for those largest areas?

Secretary BAKER. I will try to do that, Senator. Grassley, with one caveat: I don't know how big an estimating job that is for the revenue estimators, but let us do the best we can on it.

Senator GRASSLEY. Of course, you have the actual year with tax returns coming in, so we have an actual year's experience.

Secretary BAKER. We have a year's experience at rates that were not the ultimate rates.

Senator GRASSLEY. That is what I mean, at the 1987 rate.

Secretary BAKER. We will see what we can do.

Senator GRASSLEY. With the changes in the depreciation schedule for that one year.

Secretary BAKER. We will see what we can do.

TAX SIMPLIFICATION

Senator GRASSLEY. Also, along the tax bill lines, we are really getting laughed at when we call it "tax simplification." I would just like to know—now a year away from signing the bill—whether or not you still consider it a "tax simplification?"

I guess I did at the time, but now we are hearing all these reports about how the forms are so much more complicated.

Secretary BAKER. They are, Senator.

Let me refresh your recollection, if I might, about what happened in tax reform. The President presented a tax reform proposal that went quite far towards simplification. One of the first things we lost in the tax reform battle was the elimination of the State and local tax deduction. When we lost that, we lost our real shot at simplification. We, at least in the administration, certainly downplayed the simplification argument as a consideration for tax reform after that.

Many of the forms are considerably more complex—were last year, certainly—because we were in a transition year as we were moving into tax reform. As we move along, they should get somewhat more simple, but not as simple as they could have been had we stuck with the President's proposals under what was called Treasury II, his original tax reform proposal.

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DEFICITS

Senator GRASSLEY. On the issue of the projection of deficits for the 1989 fiscal year, and I suppose you would say even into the out years as well, what plans do you have, if on the target dates that we have to meet, we have not met those? Do you anticipate them from only the changes in the economic summit, or the budget summit, so that we would have suggestions for raising revenue or reducing expenditures further, or combination of both?

Secretary BAKER. We had a bipartisan leadership meeting not long ago, Senator Grassley, at the White House, and someone asked that question. The position of the administration basically is: We have no reason to think we are not going to meet these targets now. We ought to confront that issue as and when it might appear that we might not reach them. We ought not to try and make decisions now. We ought to make decisions in the context of the facts as they exist at the time a decision is needed.

There are provisions, as you know, in Gramm-Rudman-Hollings that excuse a sequester if we have two consecutive quarters of real GNP growth of 1 percent or less, or if the forecast by either OMB or CBO of 2 consecutive quarters of negative growth triggers a congressional resolution suspending GRH.

So, there are so many options. The additional option, of course, is to come up with additional spending cuts, hopefully not additional tax increases.

Senator GRASSLEY. I hope that the plan does go forth, and that there isn't any need to change the agreement that was reached, but as a matter of practice we have generally been overly rosy in our projections of growth and unemployment and interest costs, what programs are going to cost, and how much revenue might come in.

I think it is really naive to think that you don't have to be ready with something, unless you figure you can put it together in a short period of time.

Secretary BAKER. Let me take you up on your offer to refer you to a portion of the record that took place before you arrived. In answer to a question from Senator Bumpers, I made the argument that this administration's forecasts have been accused of being too rosy, but the fact of the matter is we have underpredicted growth in 4 out of the 7 years we have been here, and only overpredicted growth in 3 of those years.

As things now stand, considering that we are moving into almost the fifth month of the fiscal year, we think our projections of growth and particularly interest rates are a lot closer to the mark than those of CBO. I don't think we ought to jump to the conclusion that we are necessarily going to have to come up with something.

If we do have to come up with something, what I think should happen at that time is just what we did last year. The leadership of the Congress and the President and his representatives should sit down and work the problem out in a bipartisan and mutally agreeable way. That is what the American people want to happen, and I don't know why we can't make it happen again, since we have just finished making it happen.

Chairman STENNIS. Senator Domenici, we are back to you.

INTEREST RATES

Senator DOMENICI. Mr. Secretary, I haven't heard much discussion to this point on interest rates. We have heard a lot of discussions about what affects the deficit. My best assessment is that a 1 percent drop in the interest rate on your debt service, the T-bills, both long-term and short-term or some combination thereof, just a 1 percent drop, or 1 percent increase, which ever way you want to look at it, is between $11 and $12 billion in terms of the deficit.

In other words, if interest rates were 1 percent lower, we would reduce the debt service by $11 billion. In addition, obviously, America's system depends upon a capital formation, much of which is borrowed.

Mr. Secretary, regardless of what the Federal Reserve Chairman says about his autonomy, I hope you will answer this honestly.

It seems to the Senator from New Mexico that there is no reason for real interest rates to be as high as they are today based upon the improvements in the deficit, based upon the capital available in the world and, most important, based upon inflationary expectations.

Having nothing to do with politics or this election, I believe there are two things that are dangerous, one is high interest rates, and the other is lack of growth in the world, because I don't believe every major industrial nation can continue to want to export when there is no place to export to.

I would like you to address the interest issue and talk a moment about growth in the world and what responsibility our trading partners may have with reference to growth in the world?

I am fully aware of your assessment of the Japanese and German economy in terms of their own growth. You have pressed hard that they ought to grow, that they ought to consume more at home. I frankly think you are not going to change their culture. They are making some changes, but I think countries like Japan are going to have to invest more heavily in the under-developed countries as one approach to growth.

Secretary BAKER. Senator Domenici, your question has many parts, let me see if I can hit them all.

FEDERAL RESERVE

First of all, let me simply say that I am in fundamental agreement with the monetary policy that has been pursued by the Federal Reserve. I don't think there is any prohibition against the Treasury and the Federal Reserve working closely together. In fact, I think it is very important that the two work as closely together as possible, recognizing all the while the fact that the Federal Reserve should be independent in its management of monetary policy.

We should consult about the debt problem, and we do. We should consult about monetary policy and we do. We should consult about fiscal policy and we do. I have followed that practice through the 3 years that I have been Secretary of the Treasury with two chairmen of the Federal Reserve Board and I think, frankly, with reasonably good results.

I have absolutely no disagreement with the Federal Reserve and its conduct of monetary policy.

Senator DOMENICI. So, you agree with the Federal Reserve's approach to interest rates at this point? Do you think their conduct with reference to the discount rate and the like are all right, at this point?

Secretary BAKER. As I indicated, I am in fundamental agreement with the Federal Reserve and their conduct of monetary policy.

Senator DOMENICI. How about growth in the world?

Secretary BAKER. First, let me get to your point about real interest rates, and your comment that they were too high.

The fact of the matter, I think, Senator Domenici, is that they are really not much higher than the historical average, currently 3 to 4 percent compared to a historical average of about 3 percent.

Obviously, we all like low interest rates, at the same time we like low inflation. It is extremely important that we carefully balance those two and walk an appropriate line between the two. Let me simply say I think the Federal Reserve is doing that and is doing a very good job of that.

With respect to growth in the world, no one has been more outspoken, I think, than I have about the importance of our trading partners helping the United States carry the load, if you will.

We have enjoyed, as I indicated in my opening remarks, 64 consecutive months of expansion, the longest peacetime expansion in the history of the United States. We have taken about 60 percent of the increase in exports of the non-OPEC lesser developed world. We are the world's largest market and we have served as such for 5 years.

It is very important that other industrialized nations help the United States carry some of the load. I also mentioned in my statement that we are cooperating effectively in international economic policy with the other G–7 nations. I alluded to the Louvre Agreement. I alluded to the April agreement last year in Washington, and the December agreement among the G–7, and the fact that we are taking on our budget deficit in the United States, Germany is growing, the central banks of Europe last fall cut their interest rates in a coordinated way, Germany adopted a fiscal package of stimulative measures, Japan has increased its domestic demand rather dramatically. I think, overall there is a high degree of international economic policy cooperation and coordination, which should lead overall, Senator Domenici, to increased growth around the world.

Let me make one final point, and really this is in partial response to Senator Specter's question to me about voting for loans in the international financial institutions that somehow assist countries in manufacturing products that compete with an industry in the United States.

It is important, if we are to sustain world growth, that just by the industrial nations of the world, but by the lesser developed countries as well. One of the main mechanisms for that growth, and one of the main catalysts of that growth are the programs of the international financial institutions. So it is important that we support those programs in recognition that the world is becoming ever more an interdependent place, and it is important that we generate as much growth as we can worldwide.

Senator DOMENICI. My last question is by way of an observation and a comment that I would like your opinion on.

TAX CREDITS FOR U.S. R&D

I recently heard a lengthy briefing from American Business, and in summary it went as follows:

If you take Hewlett-Packard, just as an example of one of America's companies who is international, 50 percent of their total sales in the year 1987, 50 percent, were for products that were 3 years old or younger, product lines that were 3 years old or younger.

The next fact that was discussed was that if you take the thousand major companies and set them aside, and then pick the next 3,500 American companies—10 to 15 percent of American business—where all the growth is occurring, a Harvard University Dean who researched it, found that 50 percent of their entire product line's total sales in 1987, 50 percent, were 5 years or younger.

Then, you take the Ford recovery and find that they are now as profitable and as competitive as any Japanese automobile manufacturer.

I conclude in looking at all three of these groups that research and development, applied technology, and the retraining of the American workforce with new skills is tremendously important for this country; without it we are going to go backwards.

I have concluded that we ought to reinstate the tax credit for research by American corporations and some other things.

Would you give me your assessment of what you think those facts mean?

If those facts that I just described to you are true, what do they mean about future programs and taxes and the like as far as this country is concerned?

Secretary BAKER. First of all, let me say that I agree with you. Secondly, it seems to me that it validates the emphasis which we have put tin this budget on looking to the future, on spending our money with a futuristic approach, if you will, by increasing the budget of the National Science Foundation, for example.

I might point out, as you well know, Senator Domenici, we have very limited revenue proposals in this budget that were not a part of the Budget Summit Agreement. For the most part those revenue proposals look to enhancing the competitiveness of the United States by extending the R&E tax credit, by providing for research and experimentation allocation rules at a cost of about $600 million, so that our companies can be more competitive abroad.

It is that kind of an emphasis that we have tried to put in this budget.

Senator DOMENICI. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman STENNIS. We enjoyed having Senator Stevens here, but he has other pressing matters, as I understand.

Senator STEVENS. Mr. Chairman, I just dropped by to pay my respects to my good friend. I didn't hear the statement, so I don't have any questions, but I will read his statement.

I am delighted to see you here, sir.

Chairman STENNIS. I am glad you came by.

Senator Chiles, that brings us to you.

Senator Chiles. Thank you, Mr. Chairman.

Mr. Secretary, we are looking forward to having you come to the Budget Committee at the end of this week, but I wanted to ask you a couple of questions, if I could.

SALES OF LOANS

Last year, the administration was successful in selling loans and implementing prepayment programs to achieve a $7.4 billion in receipts for 1987. Considering the magnitude of the sales, I was favorably impressed that the agencies were able to put together workable loans in a relatively short period of time.

I have some concerns regarding the manner in which the sales were administered. Of most concern to me is the creation of senior and subordinated loan offerings, where the Federal Government retains this subordinated class of loan for up to 2 years.

When the Government retains this subordinated class of loan, the interest and principle that ordinarily would flow to the Treasury can be claimed by the holders of the senior class loans.

In other words, receipts due to the Government are used to guarantee, albeit in a limited sense, payments to private investors. That seems to smack of being a recourse loan sale to me, knowing that the administration said we were not going to have recourse loans, that has been one of the battles. Some of the people in the Congress wanted to see recourse loans, and I thought that was a battle that we won, and we were not going to have that.

Do you have some concerns?

Secretary BAKER. Senator Chiles, are you talking about the Farmers Home and the Department of Education loans?

Senator CHILES. Part of it, yes.

Secretary BAKER. It is my understanding that there is absolutely no Federal guarantee involved in any of those asset sales, and that the prospectus for each of them makes the point expressly.

Senator CHILES. But, the problem is we have not sold any of the class B loans. If you have a class A loan and you have a class B loan then whoever buys the class A sort of knows that he is going to get his interest, and that interest is guaranteed.

Yes, we haven't written on there that it is a guaranteed loan, but if the Federal Government is going to be stuck to hold the class B loan.

Let me phrase it another way: One of the things we are about in loan sales—and you are the one who, I think, first started talking about this, or one of the first ones—we want to find out what the loan is really worth, and the only way to find out is go to the marketplace and find out.

We want to know how much subsidy, let's say, how much Government subsidy is in these loans. We are not going to find that out if we have a class B loan that we are not selling, that they haven't sold.

Are we going to be able to tell what the real subsidy is?

Secretary BAKER. I guess we could tell what the class A loan is worth.

Senator CHILES. But the class A loan is looking like it is real good, because it is propped up by the class B that has not been sold.

Secretary BAKER. We can't tell what the class B is worth until we sell it.

SELLING OF CLASS B LOANS

Senator CHILES. My concern is, you will be gone in 2 years, I will be gone, too, this administration is gone and we still didn't get any idea about what the real subsidy was because we were sitting there with these class B loans.

Secretary BAKER. You want us to sell some of the class B loans?

Senator CHILES. Absolutely.

Secretary BAKER. OK, let's take a look at that. I don't disagree with your conclusion that you can't tell what they are worth until you try to sell them.

There is probably some good reason that I am not aware of, Senator Chiles, that we are concentrating on the A's now, but I would be glad to look into that as a possibility.

Senator CHILES. My concern is, one of the reasons, maybe, the A's have done so well and have gone so quickly is because the B is sitting there and is amounting to be a sort of prop up for it.

Secretary BAKER. Senator, we wanted to make sure that we were able to hit the targets. So, the simple answer to your question is, and it seems to me we ought to recognize this, we are selling the more valuable loans first.

We ought to recognize to an even greater extent, what I have been saying for a year and a half, and that is we are sitting on $155 billion of paper in that bank that isn't worth $155 billion.

Senator CHILES. My concern is that the fire sale is going to come after next year on these class B loans, and we are sort of creaming the class A and we are taking the money out of that, but, in effect, it is still sort of a backdoor subsidy that we are placing on those sales of the A's, because they are backed up by the fact that the B's are there, and you can't do anything about the B loans or pay any interest on them until you have paid it on the A's.

Secretary BAKER. Let us take a look at that, Senator Chiles. I would be glad to do that.

But, the simple answer is, yes, we are selling the ones we can sell.

Senator CHILES. I just think it is giving us a very false picture. It looks like sales are going great. These education loans, we are getting so much on these, and Farmers Home loans, we are getting so much on those, but we have a drawer full of them down here that may not be worth anything.

Secretary BAKER. I don't disagree with you at all. You are quite right, I think, I was one of the first people who suggested some time way last year——

Senator CHILES. One of the major reasons was to show the Congress and the administration what kind of real subsidy was there.

What I am saying is: What we are doing now is not going to tell us what that subsidy is until those B loans are sold.

Secretary BAKER. I think that is probably right. Until we put some of the B loans up and find out whether we can sell, you are not going to be able to measure the subsidy, at least, as far as the B loans are concerned. I don't disagree with that at all.

Senator CHILES. The other thing is that I am not sure we really know what the A loans are worth, if they were not backed up by this sort of backdoor guarantee on the B loan.

I thank you for looking into it.

Chairman STENNIS. Thank you, Senator.

Senator Grassley, you may proceed further.

NATIONAL ECONOMIC COMMISSION

Senator GRASSLEY. Mr. Secretary, the National Economic Commission that was set up to study the problems of the deficit, is it the administration's position that this would immediately go to work or that this is going to be something that is done between the election and the reporting day of March 1?

Secretary BAKER. Senator Grassley, it is the view of the administration that the Commission can and should go to work, and the President has appointed his two members.

However, it is the strongly-held view of the administration that the Commission should do its utmost not to become involved in the election, this being a Presidential election year. Therefore, the administration would hope that the Commission would not hold public hearings and institute, if you will, a public debate during the course of the election season on what its ultimate recommendations and conclusions should be.

We have absolutely no objection to the Commission beginning work, and we think, in fact, that the legislation, if it doesn't call for that, certainly permits that. We have no problem with that, but we do think it is important that the Commission be able to do its work quite apart from political imperatives, and that it not find itself somehow embroiled in the Presidential election or the general election of 1988.

CARIBBEAN BASIN INITIATIVE

Senator GRASSLEY. I have a question on the Caribbean basin initiative, and my question is related to the appropriations process in this way that I sense one of the purposes of the Caribbean basin initiative was to reduce potential claims on the Treasury for helping the Caribbean area through the promotion of private sector initiatives by the countries involved.

I think that is a worthy goal for our country to pursue, but I am concerned in regard, for instance, to some industries starting there where there is just a slight change in the commodity.

For instance, taking water out of ethanol coming into the United States from Brazil, or some refinement of wine from Europe, which I see as attempts to avoid duties coming into this country from the respective countries of origin.

So, I see the Caribbean basin initiative thwarting our own national policies in a way unintended with the beginning of the Caribbean basin initiative.

My question is: Do you see that as a problem; if you do see it as a problem, do you see things we are going to do to correct it, but in no way do I think it should be a subterfuge, the Caribbean basin initiative, for getting around the trading responsibilities that other countries have toward the United States if they would have done that direct?

Secretary BAKER. I don't think it should be used as a subterfuge either, Senator Grassley, and I would be pleased to take a look at any specifics you want to give me.

What you are talking about are the nuances and the detail in Customs' tariff schedules, and that is a very complicated, technical and difficult area. If you have some specifics, such as you mentioned—wine and ethanol—we would be glad to take a look at it and see if there is any hint of subterfuge. I am not familiar with what the specific tariffs are with regard to these particular products.

I really don't think, quite frankly, that the Customs Service is a party to any such——

Senator GRASSLEY. I think it is probably that the United States could easily be taken advantage of. I don't think it is that we aren't doing our job, I just think it is the ingenuity of people who want to avoid duty and avoid trade agreements with the United States and, quite frankly, the examples pop up so fast it is like poking your finger in a dike, you stop the water one place and it pops out another place.

I will give you two examples of the most recent ones that I am aware of, but it just seems like it is happening all the time.

Evidently, you would not agree that you see efforts of industry, generally, or the Caribbean basin initiative countries with their ingenuity using processes that would, admittedly, increase private sector efforts in their own country, increase employment in their own country, you don't see that really happening, the way I see it happening?

Secretary BAKER. No. I don't see it as a general subterfuge that is being undertaken by those countries. Quite naturally, their self interest is going to require that they do whatever they can to comply with our tariff schedules and get the benefit of lower tariffs for CBI imports.

Now, if there has been any Mickey Mousing around that you are aware of, we would be glad to take a look at it.

Senator GRASSLEY. I think the most obvious one, if Brazil was going to send ethanol and it is covered by a duty that they have to pay—legislated by us very recently—if that goes to Jamaica and they change the form of it just a little bit, as simple as taking some water out of it, then it comes into this country duty free, it seems to me like it is very obviously a subterfuge, if it wouldn't otherwise go through that process.

Secretary BAKER. Senator, if it is subterfuge, it is one that Congress can address, but even before that happens I would be pleased to take a look at any specifics that you have such as that, and get back in touch with you.

CURRENCY DEVALUATION

Senator GRASSLEY. My last question deals with the currency devaluation, the dollar vis-a-vis other currencies.

Most of the improvement of the dollar's position has been toward the major currencies of the world, like the yen and the deutsche mark; right?

Secretary BAKER. Right.

Senator GRASSLEY. What is our country's policy toward the dollar value versus some of the other currencies of countries that are major trading partners of ours, like Korea, Singapore, Malaysia, Pacific-rim countries, where I don't think that our change in policy on the position of the dollar versus any other currency has helped us materially with our trade?

Secretary BAKER. First of all, let me say that our position with respect to the dollar vis-a-vis other major industrial country currencies is is that we think any further decline of the dollar could be counterproductive. That is number one.

Senator GRASSLEY. That would be like the yen and the deutsche mark, for example?

Secretary BAKER. Yes, sir.

With respect to the position of the U.S. Government and the dollar vis-a-vis other currencies, let me simply say it is our view that countries whose economies are strengthening and countries who are running significant trade surpluses should permit their exchange rates to reflect more accurately the underlying strength of those economies.

Senator GRASSLEY. Is it a policy of our country to take the same aggressive attitude toward the dollar versus those lesser currencies the same as we did take a very aggressive approach toward the yen and the deutsche mark, as an example?

Secretary BAKER. I don't know what you mean by "aggressive approach," but if you mean by that, Senator, active——

Senator GRASSLEY. Let's put it this way: The same approach that you did in pursuing the reduction of the dollar's value versus the deutsche mark and the yen, do you have the same plans toward these other currencies?

Secretary BAKER. If you mean active consultation with these countries regarding the issue, the answer is yes.

Senator GRASSLEY. Thank you, Mr. Chairman.

Chairman STENNIS. Thank you, Senator.

I ask unanimous consent that I may file questions in the record directed to our valued witness for response at his convenience.

Chairman STENNIS. Mr. Secretary, I think you have made a contribution here today, and you were very informative in giving us the benefit of your opinions.

I will say that for the members, too, they made a contribution here, and this is the kind of hearing I like for us to have.

I thank you for them and for myself, of course, and we may be getting you back before long.

Senator Inouye asks permission to put certain questions for you in the record.

Are there any objections?

[No response.]

SUBMITTED QUESTIONS

Chairman STENNIS. The Chair hears none. It will be received. All submitted questions from members will be inserted in the record.

[The following questions were not asked at the hearing, but were submitted to the Department for respose subsequent to the hearing:]

QUESTIONS SUBMITTED BY CHAIRMAN STENNIS

NATIONAL DEBT

QUESTION: Secretary Baker, I am informed that in 1981 the national debt stood at approximately $1 trillion, and that this was a result of 200 years of inherited bills for public spending on such important events as acquiring the Louisiana Purchase, holding the Union together, overcoming the devastation of the Great Depression and winning two World Wars. Now, just 7 years later, the national debt is projected at $2.8 trillion for FY 1989. My question to you is: How did the national debt almost triple in seven short years?

ANSWER: In large measure, the increase in the debt during the 1980's reflected the severe recession early in the decade. This ballooned the cyclical portion of the deficit -- that portion which results when the economy operates at less than a normal rate of employment. The cyclical deficit plus high interest rates early in the decade left a legacy of interest payments to service the larger outstanding debt. Additionally, we were not as successful as we would have liked in holding down growth of Federal spending. Outlays averaged 23-1/2 percent of GNP over the past seven fiscal years, or about 3-1/2 percent more than averaged over the 1964-79 period.

It is noted that the figure cited for FY-1989 includes debt held by the trust funds -- in other words, debt that the Government owes itself. Excluding trust funds, the debt at the end of FY-1989 is projected to be $2.15 trillion, including debt held by the Federal Reserve System. That would represent 43 percent of GNP, the same percentage as back in 1963 and less than in any postwar year prior to that. At the end of World War II, the Federal debt was greater than our GNP.

"SUPPLY-SIDE" ECONOMIC POLICY

QUESTION: Secretary Baker, last week we heard the Director of OMB, Dr. James Miller, tell this Committee about the longest peacetime economic expansion -- 63 months worth -- in U.S. history. And yet we know that over the same period of time -- from November 1982 until the present -- the cumulative federal budget deficit totalled $1.1 trillion dollars. Does the Administration now acknowledge that its "supply-side" economic policies, which were supposed to erase the budget deficit, have instead created a legacy of debt which imperils the future well-being of our Nation?

ANSWER: On balance, we believe that history will view the economic policies put in place by this Administration as having been highly successful.

- Inflation has been cut from the double-digit rates inherited when we came into office. Interest rates have been brought down from the more than 21 percent reached at the end of 1980.

- We have experienced the longest peacetime economic expansion in U.S. history. Nearly 15 million more Americans are working now than were employed in December 1980.

- Our tax system has been reformed. Marginal rates have been reduced so that taxpayers have a vastly greater incentive for additional effort.

- We have reversed the steady expansion of the Federal Government and its intrusion into the workings of the economy.

Overall, we believe the conditions have been put in place that will permit solid, sustained economic growth in the years ahead. Certainly, the increase in the debt is one development about which we are dissatisfied. We regret we were not more successful in holding down the rate of growth of Federal spending. However, at 43 percent of GNP, or much less than in the early postwar years, the debt should not be a serious burden on future generations.

QUESTION: Secretary Baker, the enormous trade imbalances between the United States and its trading partners stem largely from policy decisions made in this country and abroad during the past decade. What specific actions is the Administration embarked upon to facilitate a reduction of the current trade deficit?

ANSWER: The emergence of the very large U.S. trade deficit, and the counterpart Japanese and German surpluses, during the 1980s is the result of several factors, among the most important of which were growth of U.S. output and employment which was stronger than growth in the other major industrial countries, and the period of dollar appreciation ending in early 1985.

o We are moving on a variety of fronts to reduce these imbalances.

  -- The dollar has declined roughly 38 percent on average from its peak in early 1985 against the currencies of the other industrial countries, particularly countries with large trade surpluses such as Japan and Germany. Over time, this should help to reduce the U.S. trade deficit, making foreign goods more expensive and U.S. goods more attractive in price.

  -- The U.S. and the other major industrial countries are cooperating to better coordinate the "fundamentals" in their individual national economies, to reduce the importance of disparities in policies and performance as sources of instability.

-- Substantial progress has been made in implementing this process, with specific actions including U.S. budget deficit reduction, Japanese actions to stimulate domestic demand, and German measures to cut taxes and encourage investment.

o The most recent numbers indicate that these developments are beginning to have a visible effect:

-- The trade balance has improved in volume terms since the third quarter of 1986; volume numbers lead value improvement;

-- The balance in value terms leveled off during 1987, and appears to have turned around;

-- The January figure was $2 billion below the fourth quarter average, over $20 billion annual rate better than the 1987 total.

COMPARISON OF THE FY 1988 AND FY 1989 BUDGET ESTIMATES OF THE EFFECT OF TAX REFORM ON FY 1987 RECEIPTS

The attached table compares the revenue estimates for Fiscal Year (FY) 1987 for the ten largest provisions of the Tax Reform Act of 1986 as estimated in the Administration's FY 1988 (February 1987) and FY 1989 (February 1988) budgets. Revisions in the estimates between the two budgets occur for four possible reasons: 1) a later economic forecast, 2) collections experience during FY 1987 (October 1986 - September 1987), 3) preliminary tabulations of 1986 individual income tax returns, and 4) other technical revisions.

The largest revision is in the estimate of the effect of the increase in the capital gains tax rate, Taxpayers realized capital gains in 1986 at a higher level than originally anticipated.

The next largest revision is in the estimate of the effect of the changes in individual income tax provisions, particularly the reduction in marginal tax rates. Personal income in the FY 1989 budget is higher than originally forecast in the FY 1988 budget. Higher personal income increases the cost of individual rate reductions, but actually increases total receipts collected by the Federal Government.

The estimates of the other provisions did not change significantly between the 1988 and 1989 budgets. The total change in the estimates show a $2.8 billion increase in receipts from the Tax Reform Act in Fiscal Year 1987.

Office of Tax Analysis
Department of the Treasury
March 21, 1988

Comparison of the FY 1988 and FY 1989 Budget Estimates of the Effect of Tax Reform on FY 1987 Receipts

($ Billions)

Ten Largest Tax Reform Act Provisions	Fiscal Year 1987 Estimates in:		
	FY 1988 Budget	FY 1989 Budget	Difference
Individual Income Tax Provisions 1/	-36.3	-41.0	-4.7
Investment Tax Credit	24.9	25.1	0.2
Individual Capital Gains	12.5	18.7	6.2
Corporate Rate Structure	-6.6	-6.9	-0.3
Uniform Capitalization Rules	6.2	6.2	0.0
Corporate Minimum Tax	2.7	2.6	-0.1
Modify ACRS System	-2.3	-2.4	-0.1
Three Year Recovery Rule	1.9	1.9	0.0
Estimated Payment Rules (Individuals)	1.6	1.6	0.0
Individual Minimum Tax	1.4	1.4	0.0
All Other Provisions (Net)	12.6	14.1	1.6
Total, All Provisions	18.5	21.4	2.8

Department of the Treasury
Office of Tax Analysis

March 21, 1988

1/ Includes changes in rate structure, exemptions, allowable deductions, and exclusions.

QUESTIONS SUBMITTED BY SENATOR INOUYE

FOREIGN ASSISTANCE FUNDING

QUESTION: The bipartisan budget summit agreement provided for a maximum across the board growth of 2 percent in federal spending. Yet, the President's FY 1989 budget provides for only a 1.6 percent growth in the budget authority for international programs and a drop of 1 percent in outlays over FY 1988. As a result, the world-wide humanitarian programs of the United States are being forced to take a disproportionate cut in their funding.

1. If a 2 percent growth rate in spending is the level agreed to by Congress and the President in November, why is the Administration unwilling to meet that level in foreign assistance funding?
2. Will you support a restoration of the funding level promised by the President to the American people?

ANSWER: The Bipartisan Budget Agreement provided for an aggregate increase of 2 percent in the Foreign Affairs (Function 150) Account. The $18.1 billion FY 1989 request for the 150 account is consistent with the Agreement.

However, programmatic decisions of how to allocate this funding remain with the Administration, and not all of the components of the 150 account were given identical increases. For the multilateral development banks, as an example, the Administration's FY 1989 request is around 10 percent greater than the FY 1988 appropriation. To make up for this above average increase, some accounts, such as Development Assistance, received below average increases. In judging this outcome, however, it is important to consider how well a particular account fared in the FY 1988 appropriation.

HAS THE BAKER PLAN SUCCEEDED?

Question: In 1985 you introduced your Program for Sustained Growth to aid the most indebted nations. Your plan called for a case-by-case evaluation of their needs, no compulsory cancellation or forgiveness of debt and no government bailouts. Instead, you proposed a substantial infusion of new money to help facilitate growth-oriented economic reforms, new commercial lending, and increased lending by the IMF and the World Bank. The fact remains, however, that your plan provided for no new incentives for increased lending and so a diminishing amount has occurred.

1. How do you plan to modify your program to account for this new realism?

2. Do you see any expanded role for creditor governments to play in the lessening of LDC debt?

3. What advice would you give to developing countries which are unable to compete in global export markets because of subsidies provided by the industrialized nations to their own producers?

Answer: To help sustain the considerable progress that has been made under the strengthened debt strategy, we have encouraged the commercial banks to develop a "menu" of alternative new money options from which all banks with debt exposure can choose in providing support for debtor reforms. Such menus can include balance of payments loans; trade and project finance; on-lending facilities; debt/equity, debt/conservation, and debt/bond swaps; new money bonds; exit bonds; and even limited, voluntary interest capitalization. The Mexican collateralized debt conversion proposal is the most recent example of a possible "menu" item and we anticipate continued development of other new financial instruments to meet the particular needs of both creditors and debtors. Such "menu" options are now expected to be a regular part of new financing packages. New commercial bank commitments since October 1985 for the major debtors have now totaled some $19 billion, while new commitments by the IMF and World Bank during this period have totaled $17 billion.

The creditor nations must strive to maintain open and growing world markets and encourage adequate international financial support for debtor reform efforts. The United States is playing a crucial role in coordinating these efforts. In addition to the development of the "menu" approach, we have supported negotiations on a global capital increase for the World Bank and proposed the creation of a new IMF External Contingency Facility to help cushion the effect on IMF standby programs of unforeseen external developments, such as weaker commodity prices or sustained higher interest rates.

Under the auspices of the Uruguay Round of Trade Negotiations, the LDCs should press for stronger discipline over the use of subsidies. However, they themselves must also act more responsibly in adopting subsidies.

Baker Opposition to IMF Special Fund

Question:

Recently, the IMF announced the creation of a new $8.4 billion special fund aimed at helping the world's most impoverished nations meet their long-term monetary obligations. The plan was endorsed by the leaders of the seven industrialized nations at the Venice summit last June. Yet, you were quoted at the IMF-World Bank annual meeting in Washington last fall as saying that the U.S. could not support the fund because of the U.S. budget deficit. You indicated that responsibility should rest primarily with countries with trade surpluses.

1. Should the United States continue to play any role in the long-term adjustment of less developed countries? If so, what role?
2. What relationship, if any, do you see between the health of LDC economies and the prosperity of the U.S. economy?

Answer:

We welcome the establishment of the Enhanced Structural Adjustment Facility (ESAF) and believe that it can make an important contribution to helping the poorest countries implement the longer-term structural reforms necessary for growth and development. We believe, however, that surplus countries are in the strongest position to contribute to the ESAF. Because of existing U.S. budgetary constraints, the Administration has clear priorities regarding the funding of assistance programs. We believe that a general capital increase for the World Bank is a critical priority at this stage. Further, U.S. funding through a number of bilateral and multilateral programs will support the poorest countries that also benefit from the ESAF.

We remain particularly concerned about the lagging economic development in the poorest countries, especially Sub-Saharan Africa. We have taken a leading role in formulating the IMF/IBRD policy framework program to advance structural reforms in the poorest countries and to ensure coordinated financing by the IMF, World Bank and other bilateral and multilateral agencies. We are focusing our own bilateral assistance on those countries that are encouraging the private sector and are undertaking economic reforms. We strongly encouraged the decision to direct 45-50% of the IDA VIII replenishment to Sub-Saharan African nations and to utilize $3-3.5 billion of the replenishment, to the extent that opportunities arise, for adjustment lending by the World Bank. We also support offering longer repayment terms on reschedulings of official debt involving heavily-indebted, low-income countries confronting protracted balance of payments problems.

On a bilateral basis, new commitments of U.S. assistance to Africa increasingly are coordinated with other donors and provided in the form of grant aid.

In fact, almost all of the 1987 economic aid to Africa was in grant form. Moreover, the U.S. remains the largest provider of Overseas Development Assistance.

Our inability to contribute to the ESAF does not reflect any diminution of our support for the poorest countries. We recognize it is in our best economic, financial and security interests to foster stronger growth in developing countries. Sustained growth in developing nations will benefit U.S. export opportunities, jobs and ultimately our own growth.

THE RECENTLY ENACTED FMS DEBT REFINANCING PLAN

QUESTION:

1. Will the rules written by Treasury include any restrictive language?

2. How will the Treasury respond to our call for the refinancing of arrears?

ANSWER:

1. Treasury will publish Interim Regulations governing the refinancing provision as called for in the enabling legislation. The regulations will be effective immediately upon publication, while still allowing for a 30 day public comment period before Final Regulations are issued. In keeping with the legislation, 90 percent of the privately placed refinancing loans will be guaranteed by the Defense Security Assistance Agency. The 90 percent guarantee applies to the new loan and any portion or derivative of the loan and cannot be separated from the unguaranteed portion at any time during the life of the loan.

2. These regulations follow the intent of the legislation by enabling borrowers to refinance their FMS debt and arrearages.

NEW SOCIAL INDICATORS NEEDED

QUESTION: For many years experts in the field of development have argued that economic indicators such as gross domestic product, per capita output, and growth in the labor force should be replaced by the standard use of social indicators like female literacy, infant mortality, nutritional intake, and average life expectancy which more accurately measure the progress, or lack of progress, of developing nations. A move now is underway to bring about such a change at the World Bank and other finance and development institutions.

1. Will you lend your support and voice to this effort?

ANSWER: We believe that both economic and social indicators are indispensable tools in decision-making regarding development assistance, and would not favor giving up either one. It is true that historically economic indicators have played a more prominent role, but the balance is rapidly being corrected. Increasing attention is being given to social indicators for borrowing countries, especally in Africa. To improve this data, both the World Bank and the International Monetary Fund, in cooperation with such other agencies as the United Nations Children's Fund (UNICEF), are working to develop and refine their measures, data collection, and analysis of the social dimensions of development, particularly with regard to the impact of economic adjustment programs. As a result of these efforts, all development institutions will be much better able to take into account the social impact of their activities in planning and assessing their lending activities.

QUESTIONS SUBMITTED BY SENATOR KASTEN

MANUFACTURING VERSUS SERVICE-SECTOR JOBS

QUESTION: Would you please provide information on the growth in manufacturing industry jobs compared to those in the service sector?

ANSWER: During 1987, jobs in manufacturing rose by 414,000 or by 2.2 percent (measured December to December), following two yearly declines. The gain in part reflected the impact of the improving U.S. trade situation due to a more reasonably valued dollar. Employment in the service sector rose by 2.5 million or 3.2 percent last year.

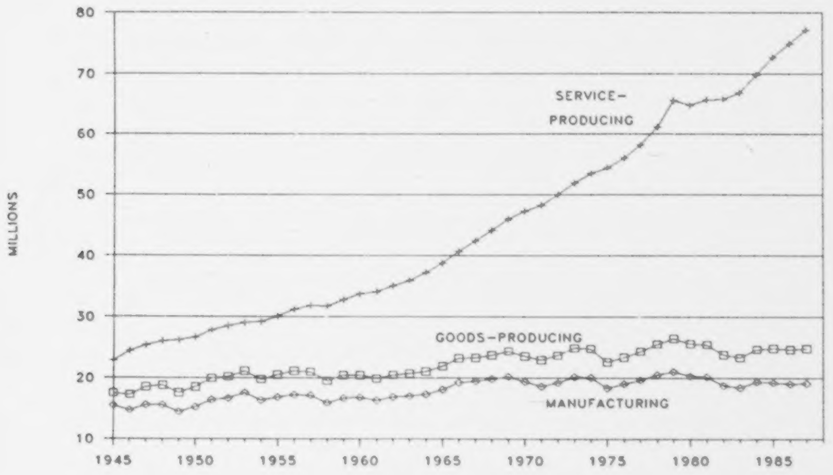
Throughout the post-World War II era service-sector jobs have risen faster than those in manufacturing, as indicated in the table below. (Manufacturing is the major component of the goods-producing sector, which also includes mining and construction.) As a result, the share of nonfarm establishment employment accounted for by jobs in manufacturing has fallen from about 34 percent in 1950 to close to 19 percent last year. Even so, the level of employment in manufacturing has been remarkably constant for more than two decades, at a little over 19 million. Service sector jobs have nearly doubled during that time period to more than 77 million in 1987. (See chart on next page.)

Growth of Jobs by Sector
(percent change at an annual rate)

	Service Sector	Goods Sector	Manufacturing
1950-60	2.4	1.0	1.0
1960-70	3.4	1.4	1.4
1970-80	3.2	0.8	0.5
1980-87	2.5	-0.4	-0.8

Despite of this shift in the composition of jobs, the U.S. economy has been able to produce a fairly constant share of manufacturing output throughout the postwar era. In fact, in 1986 (latest available) the manufacturing share of real GNP was 21.9 percent, above the long-term average of 21.3 percent. It is likely that the ratio climbed still higher last year, reflecting strong industrial production.

A relatively constant output share in the face of a declining employment share in the postwar period has been possible because manufacturing productivity has generally outpaced that of the service sector. Productivity growth in manufacturing has been particularly strong during the decade of the 1980s, rising at an average annual rate of 4.0 percent, nearly double the 2.3 percent averaged in the previous three decades.


NONFARM PAYROLL EMPLOYMENT

The strong productivity performance in recent years has combined with moderate wage increases to help make American factory workers more competitive internationally -- an important factor contributing to the rise of real U.S. net exports since 1986-III.

The outlook for both manufacturing and service-sector jobs continues to be favorable, although the Administration forecasts employment growth overall to decelerate in 1988 to 1-1/2 percent (fourth quarter to fourth quarter) from 2-3/4 percent last year, due to a slower economy. Because the improving trade balance is expected to account for about half of real GNP growth this year, as well as a significant portion in 1989, employment in manufacturing should continue to rise. Service-sector employment should also increase and, at least in the long run, will probably continue to grow more rapidly than manufacturing employment, reflecting slower productivity growth in the services.

It should be kept in mind that shifting shares of employment are signs of a dynamic economy. The 15 million gain in total employment during the current expansion has far outpaced the performance of Japan and Europe combined. Although the rise of service-sector jobs has often been mistakenly characterized as somehow less valuable than a rise in manufacturing jobs, recent analysis has shown that a disproportionately large share of jobs growth in the service sector has been in managerial and administrative jobs, which tend to have the most educated workers and pay the highest wages.

COMMITTEE RECESS

Chairman STENNIS. Mr. Secretary, is there anything that you wish to add now?

Secretary BAKER. I don't believe so, Mr. Chairman. Thank you very much for having me this morning.

Chairman STENNIS. We have gained by it and appreciate it very much. I am glad we moved along and covered so much ground at the same time.

[Whereupon, at 12:17 p.m., Tuesday, March 1, the committee was recessed to reconvene at 10 a.m., Friday, March 4, 1988.]

BUDGET OVERVIEW FOR FISCAL YEAR 1989

FRIDAY, MARCH 4, 1988

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 10:04 a.m. in room SD-192, Dirksen Senate Office Building, Hon. John C. Stennis (chairman) presiding.

Present: Senators Stennis, Burdick, Lautenberg, Hatfield, Stevens, Nickles, and Grassley.

CONGRESSIONAL BUDGET OFFICE

STATEMENT OF JAMES L. BLUM, ACTING DIRECTOR AND ASSISTANT DIRECTOR FOR BUDGET ANALYSIS, CONGRESSIONAL BUDGET OFFICE

OPENING REMARKS OF CHAIRMAN STENNIS

Chairman STENNIS. May we have quiet, now, and everyone take seats, please. Ladies and gentlemen, I regret that for our hearing today it turns out that the Senate is in session this morning, beginning at 10 o'clock. I expect it will be in session all day. It is just one of those things that we both have to move along, and we will move forward. We will get this matter all fully covered.

One of the most important aspects of this hearing, is to get it in the record, the official estimate and official statements all put in the record and available to the public or any individual that might seek it from a published document and so forth. So we will just move forward and proceed in a normal way.

INTRODUCTION OF JAMES BLUM

We will continue now, as the Senate Appropriations Committee continues in its overview hearing on the President's proposed budget for fiscal year 1989. Today, we will hear the testimony from Mr. James M. Blum, Acting Director of the Congressional Budget Office who will present CBO's annual analysis of the President's budget to the committee.

We are really pleased to have you here, sir, your name and your profession and your field of activity. We are glad to give you a special welcome, to review your testimony and it is certainly of importance. I want to commend you and the Congressional Budget Office for the excellent work you have done in providing objective analyses to this committee and to the Congress as a whole.

In particular, I wish to commend you for your recent support of the economic and budget outgrowth for fiscal years 1989 through 1993, and today, to receiving your forthcoming annual report of the Senate Appropriations Committee, the President's budgetary report for 1989.

OMB/CBO BUDGET DIFFERENCES

I know you are here this morning to present to this committee CBO's analyses to the President's 1989 budget. I believe that Members will be very interested in a number of areas, but in particular, I hope that you will highlight those areas where there may be a difference of opinion between the Office of Management and Budget and the Congressional Budget Office, and you will tell us what the consequences could be if CBO viewpoints are to be the correct ones.

PROJECTED DEFICIT FOR FISCAL 1989

I want to mention two such areas and would hope that you would address these and others for us in the course of your presentation this morning. First, the President's budget package projects a deficit for 1989 of $125.5 billion, which falls within the revised target of $136 billion under the new Gramm-Rudman-Hollings law.

However, the Congressional Budget Office now projects a deficit for 1989 of $166 billion, thus exceeding the new target by $36 billion. Second, the administration's long-term projections for the deficit indicate that in 5 years it will have been reduced down to $23 billion. In contrast, the Congressional Budget Office projects that the budget deficit in 1993 will be six times that figure, or $134 billion. It is no reflection on anyone that we disagree some, but this is a wide margin of difference. It is highly important and highly valuable if we have all these figures before us. I understand that economic forecasting is an inexact science, but over and over, we see wide differences of opinion between the Office of Management and Budget and the Congressional Budget Office.

I say that your efforts here at helping to understand why there may be these differences of opinion and what the consequences could be are much appreciated by the committee. The outstanding contribution that will be made today is, I think, that testimony of this kind is highly valuable. It will be available to everyone, including the Members, and then a show-down; the members have to pass the balance and make their conclusions and thereby try to lead the way.

I was going to call on Senator Hatfield at this time, but I am advised now that we have a vote going on the floor of the Senate, and the vote is a motion to table the McClure amendment on the Intelligence Oversight Bill. I call that out for anyone that wishes to go. I think for the time being we will just proceed and I will make up my mind later.

Again, I emphasize that we feel the need to have you here today, and we would like to have you here, and you won't be circumscribed in anyway. There will be some questions, so you just proceed. We won't go over questions at this time.

SUMMARY OF PRESIDENT'S BUDGET

Mr. BLUM. Thank you, Mr. Chairman. I appreciate the kind words that you have said about our work. We are very pleased to be here this morning to summarize the findings of our analysis of the President's budget. We prepared it at the request of your committee. This is, I think, the 7th or 8th year that we have done that for the Senate Appropriations Committee, and we appreciate doing it for you.

The actual analysis will be released next week. It will be going to the printer early next week, and it will come out, hopefully, next Thursday, March 10.

CBO BUDGET ESTIMATES

The CBO estimates that the Federal deficit under the administration's policies would be $165 billion in 1989, falling somewhat to $157 billion in 1990 and $109 billion in 1993. These figures are considerably higher than the administration's own estimates, which are $130 billion in 1989, $104 billion in 1990, and $23 billion in 1993.

TABLE 1. CBO AND ADMINISTRATION ESTIMATES OF THE ADMINISTRATION'S BUDGET PROGRAM
(By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Estimates						
Revenues						
Administration	909	965	1,044	1,124	1,190	1,258
CBO	899	955	1,038	1,113	1,182	1,262
Outlays						
Administration	1,056	1,094	1,148	1,204	1,241	1,281
CBO	1,060	1,120	1,195	1,253	1,313	1,371
Deficit						
Administration	147	130	104	79	51	23
CBO	161	165	157	140	131	109
Differences in Estimates						
Revenues						
Technical	-3	-2	2	-1	a/	2
Economic	-7	-8	-8	-11	-9	2
Total	-10	-10	-6	-12	-8	4
Outlays						
Technical	1	9	14	1	6	1
Economic	3	17	33	48	66	88
Total	4	26	47	49	72	90
Deficit						
Technical	4	11	12	2	5	a/
Economic	10	25	41	59	75	86
Total	15	36	53	61	80	86

SOURCE: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.

a. Less than $500 million.

Table 1 shows our estimates in conjunction with those of the administration. The lower panel on that table shows how CBO estimates the administration's budget——

Chairman Stennis. Excuse me just a minute. You need just a little more volume in this transmitter. I don't know whether it is adjustable there or not. If it is, if you can turn it up a little; if not, why you will have to speak up.

Mr. Blum. All right. Is this better now?

Chairman STENNIS. Yes. That's better.

Mr. BLUM. All right. Fine.

I was saying that the lower panel of the table on the next page shows how the CBO reestimates are divided into those that result from differing economic assumptions and those resulting from different technical estimates. Most of the differences between the Congressional Budget Office and the administration reflect assumptions about the future of the economy. CBO foresees less rapid real growth, higher inflation, and higher interest rates than does the administration.

BASELINE BUDGET PROJECTIONS

Mr. Chairman, CBO analyzes the President's budget in terms of changes from the CBO baseline, which projects the course of the budget on the assumption that current taxing and spending policies continue unchanged. CBO reestimates or reprices the administration's budget, using our economic and technical estimating methods. The differences between the baseline projections and the CBO estimate of the President's budget measure the effects of the administration's proposed policy changes.

As in past years, the baseline budget projections assume that revenues, offsetting receipts and entitlement spending are projected according to the laws now on the statute books. Defense and nondefense discretionary appropriations are assumed to hold constant in real terms.

This year CBO has made minor changes in its baseline to make it identical to the budget base as specified in the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987, that was enacted last fall. We hope that this move will eliminate any confusion that has resulted in the past from having more than one set of baseline projections.

Looking at our baseline first, we have the budget deficits rising from $150 billion in 1987, the last complete fiscal year, to $161 billion in the current year, 1988, and to $177 billion in 1989 before a drop to $170 billion in 1990.

These baseline projections update those published last month in our annual report, "The Economic and Budget Outlook: Fiscal Years 1989–1993," which you referred to in your opening statement.

The near-term revisions stem largely from an accounting change for outlays. In its 1989 budget submission, the administration announced that the issuance of certain promissory notes by the Federal Savings and Loan Insurance Corporation and the Federal Deposit Insurance Corporation will henceforth be counted as budget outlays, just as the FDIC demand notes have been treated as outlays since the 1988 budget. This accounting change alone adds $4 billion to outlays and the deficit in 1988 and another $2 billion in 1989.

CBO'S ECONOMIC ASSUMPTIONS

The key difference between our deficit estimates, as you indicated in your opening remarks, Mr. Chairman, and as I stated earlier, result from different economic assumptions underlying the budget projections. CBO expects slower real growth, higher inflation and higher interest rates during the next 2 years than does the administration. The comparison of our short-term forecast with that of the administration is shown on table 2.

TABLE 2. CBO, ADMINISTRATION, AND CONSENSUS FORECASTS FOR 1988 AND 1989 (By calendar year)

	Actual	Forecast	
	1987	1988	1989
Fourth Quarter to Fourth Quarter (Percent change)			
Real Gross National Product			
CBO	3.8	1.8	2.6
Administration	3.8	2.4	3.5
Consensus	3.8	1.8	2.1
GNP Deflator			
CBO	3.3	3.9	4.2
Administration	3.3	3.9	3.7
Consensus	3.3	3.7	4.4
Consumer Price Index (CPI-W)			
CBO	4.5	4.9	4.8
Administration	4.5	4.3	3.9
Consensus	4.5	4.1	4.8
Calendar-Year Average (Percent)			
Three-Month Treasury Bill Rate			
CBO	5.8	6.2	6.7
Administration	5.8	5.3	5.2
Consensus	5.8	5.9	6.4
Ten-Year Government Note Rate			
CBO	8.4	9.3	9.5
Administration	8.4	8.0	7.4
Consensus a/	8.4	8.9	9.1
Civilian Unemployment Rate			
CBO	6.2	6.2	6.1
Administration b/	6.1	5.8	5.6
Consensus	6.2	6.1	6.2

SOURCE: Congressional Budget Office; Office of Management; Blue Chip Economic Indicators (February 10, 1988).

NOTE: The CBO forecast is based on the preliminary estimates of GNP for the fourth quarter of 1987 released in January 1988; the February revisions were small and are not included.

a. Averages are calculated by using CBO's projection of the difference between the corporate bond rate and the 10-year government note rate.

b. The Administration's projection is for the total labor force, including armed forces residing in the United States. In recent years, this rate has tended to be 0.1 to 0.2 percentage points below the civilian unemployment rate.

I must say, however, that the CBO forecast is similar to the consensus of private sector forecasters. CBO projects that real Gross National Product will grow by 1.9 percent in 1988 measured on a fourth-quarter-over-fourth-quarter basis, the same as the consensus by the forecasters.

This forecast reflects very slow growth in the first half of the year followed by a rebound in the second half.

ADMINISTRATION BASELINE

The administration, however, expects consistent 2 to 2½ percent real growth throughout 1988. In 1989, CBO expects real GNP to grow by 2.6 percent, somewhat less than the administration's forecast of 3.5 but above the consensus forecast of 2.1 percent. Like most private forecasters, the Congressional Budget Office expects both short- and long-term interest rates to rise over the next few years, while the administration projects them to decline. In large part, these differences reflect different views about inflation. CBO expects consumer price inflation to accelerate slightly in the near term as the falling dollar generates higher import prices, while the administration assumes that inflation rates will decline.

Beyond 1989, neither CBO nor the administration attempts to forecast the economy. Rather, both agencies make projections based on historical trends. As in the short-term outlook, CBO's longer run economic assumptions are less optimistic than those of the administration but similar to those of most private sector forecasting firms. This comparison is made in table 3.

TABLE 3. COMPARISON OF CBO, ADMINISTRATION, AND PRIVATE-SECTOR ECONOMIC ASSUMPTIONS
(By calendar year)

	1987	1988	1989	1990	1991	1992	1993
Nominal GNP (Billions of dollars)							
CBO	4,486	4,744	5,068	5,414	5,782	6,179	6,606
Administration	4,486	4,779	5,113	5,481	5,850	6,207	6,548
DRI	4,486	4,710	5,043	5,425	5,795	6,192	6,641
Wharton	4,480	4,752	5,063	5,356	5,728	6,082	6,499
Real GNP (Billions of 1982 dollars)							
CBO	3,820	3,906	4,008	4,113	4,220	4,333	4,450
Administration	3,820	3,932	4,054	4,196	4,340	4,485	4,630
DRI	3,820	3,895	4,021	4,140	4,232	4,317	4,406
Wharton	3,814	3,901	3,996	4,063	4,199	4,310	4,446
Real GNP (Percent change, year over year)							
CBO	2.9	2.3	2.6	2.6	2.6	2.7	2.7
Administration	2.9	2.9	3.1	3.5	3.4	3.3	3.2
DRI	2.9	2.0	3.2	3.0	2.2	2.0	2.0
Wharton	2.7	2.3	2.4	1.7	3.3	2.7	3.1
Three-Month Treasury Bill Rate							
CBO	5.8	6.2	6.7	6.6	6.4	6.1	5.9
Administration	5.8	5.3	5.2	5.0	4.5	4.0	3.5
DRI	5.8	5.3	6.0	6.3	6.3	6.2	6.2
Wharton	5.8	6.3	7.6	6.9	6.5	6.4	6.6
Ten-Year Government Note Rate							
CBO	8.4	9.3	9.5	9.0	8.4	7.8	7.4
Administration	8.4	8.0	7.4	6.8	6.0	5.0	4.5
DRI	8.4	8.1	8.4	8.6	8.6	8.7	8.7
Wharton	8.3	9.3	10.0	9.2	8.1	8.1	8.2
CPI-W (Percent change, year over year) a/							
CBO	3.6	4.5	4.9	4.6	4.4	4.4	4.4
Administration	3.6	4.3	4.1	3.6	3.2	2.7	2.2
DRI	3.6	3.9	4.6	4.9	4.7	5.0	5.2
Wharton	3.5	4.5	4.7	4.0	4.2	4.2	4.1

SOURCES: Congressional Budget Office; Office of Management and Budget; Data Resources, Inc. (February 2, 1988); Wharton Econometric Forecasting Associates (February 8, 1988).

a. CPI for urban wage earners and clerical workers.

CBO's estimates of the deficit exceed the administration figures by $15 billion for the current fiscal year, 1988, $36 billion in 1989, and increasing amounts in later years.

In 1989, $25 billion of the $36 billion in reestimates is attributable to different economic assumptions. In 1991 through 1993, virtually all of the adjustments are economic.

LOWER REAL ECONOMIC GROWTH AND INTEREST RATES

CBO's assumptions of lower real economic growth and higher interest rates tend to increase estimated deficits while our assumption of higher inflation tend to lower them, as is shown in table 4.

TABLE 4. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S DEFICIT (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Lower Real Economic Growth	7	12	20	34	51	67
Higher Interest Rates	2	13	23	32	41	52
Higher Inflation a/	1	b/	-2	-7	-17	-33
Total Economic Reestimates	10	25	41	59	75	86

SOURCE: Congressional Budget Office.

NOTE: The figures include the changes in debt service costs caused by different borrowing.

a. Any effect of inflation on interest rates is included in the previous line.

b. Less than $0.5 billion.

Lower real economic growth holds down tax receipts while increasing outlays for unemployment insurance and related programs. CBO's real-growth assumption adds to the deficit in the President's budget by amounts growing from $7 billion in 1988 to $12 billion in 1989 and $67 billion in 1993. Higher interest rates also increase debt service costs by $2 billion in the current fiscal year, $13 billion in 1989 and $52 billion in 1993.

DIFFERENCES IN INFLATION ASSUMPTIONS

Our differences in inflation assumptions have little effect on the deficit estimates in the first few years, but CBO's higher assumed inflation rates reduce the estimated deficits in the out-years by $7 billion in 1991, $17 billion in 1992 and $33 billion in 1993.

In the long run, faster inflation increases most revenue sources by increasing taxable incomes and consumption, but raises only some outlay categories, primarily indexed benefit programs, Medicare, and Medicaid. CBO bases its estimates of defense and nondefense discretionary appropriations on the dollar amount in the administration's request. It does not increase the request to take into account CBO's higher assumed inflation rates. If CBO's inflation rates prove correct, then, of course, these appropriations will buy fewer real goods and services than the administration now anticipates.

EFFECT OF TECHNICAL ASSUMPTIONS

The technical reestimates that I referred to increase the estimated 1989 deficit by $11 billion, which is comprised of $2 billion in lower revenues and $9 billion in higher outlays. This is shown in more detail in table 5.

TABLE 5. CBO REESTIMATES RESULTING FROM DIFFERENT TECHNICAL ASSUMPTIONS (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Revenues	-3	-2	2	-1	a/	2
Outlays						
National defense	2	1	a/	1	a/	-1
Nondefense discretionary appropriations	-1	a/	-3	-2	a/	1
Arctic National Wildlife Refuge leasing	0	0	2	-2	1	-1
Farm price supports	-1	a/	a/	-1	-2	-2
Deposit insurance	-1	2	1	a/	a/	-1
Postal Service	a/	a/	1	-3	-1	-3
Medicare	1	2	2	2	1	a/
Income security	a/	2	3	4	3	5
Net interest	2	a/	2	1	2	1
Asset sales and prepayments	-1	4	3	a/	a/	a/
Other	a/	a/	-1	0	2	1
Total Outlays	1	9	14	1	6	1
Total Technical Reestimates	4	11	12	2	5	a/

SOURCE: Congressional Budget Office.

a. Less than $0.5 billion.

DISCRETIONARY ACCOUNTS

Of the outlay differences, only a small portion involves discretionary accounts; roughly half a billion is in national defense programs and slightly less than $.5 billion are in nondefense discretionary appropriations.

The nondefense discretionary differences are quite small, because the administration generally elected to use CBO estimates for these accounts in preparing its 1989 budget.

OUTLAY ESTIMATES FOR DEPOSIT INSURANCE

CBO's 1989 outlay estimates for deposit insurance, Medicare, and various income security programs are each $2 billion higher than the administration's, and CBO expects a total of $4 billion ~~in~~ lower proceeds from asset sales and loan prepayment.

OUTLAYS IN 1990

Many of the same technical factors that increase the 1989 deficit also add to outlays in 1990. In addition, CBO believes that the first auction for drilling rights in the Arctic National Wildlife Refuge cannot occur before 1991. The administration assumes that if the Congress acts this year leasing could actually begin in 1990. By increasing the deficit, the technical reestimates also increase interest costs by $2 billion in 1990. After 1990, however, these technical reestimates are quite small in total.

ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the administration's budget program can be measured. As I said before, by comparing our estimate of the President's budget against our baseline, we can measure the effects of proposed policy changes.

This year, the administration budget would cut the projected deficits relative to our baseline projections only very modestly, but the amount of deficit reduction would grow by about $95 billion over the next 5 years, or by 12 percent of the projected baseline deficits.

This is a relatively small amount in comparison with the budgets that are proposed in past years. Small increases in defense spending and cuts largely in nondefense discretionary programs and in entitlement programs make up the bulk of the proposals. The details of these policy changes measured relative to the CBO baseline are summarized in Table 6.

TABLE 6. THE ADMINISTRATION'S BUDGET PROGRAM AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
CBO Baseline Deficit	177	170	159	154	139
Policy Changes					
Revenues a/	-1	-1	-1	-1	-1
National Defense	-1	b/	1	3	5
Nondefense Discretionary Spending	-2	-2	-8	-12	-16
Entitlements and Other Mandatory Spending	-3	-6	-6	-6	-6
Offsetting Receipts	1	b/	-4	-4	-6
Asset Sales and Prepayments	-6	-3	b/	b/	b/
Net Interest	b/	-1	-2	-4	-5
Total Policy Changes	-12	-12	-19	-23	-29
Deficit, President's Budget as Estimated by CBO	165	157	140	131	109

SOURCE: Congressional Budget Office.

a. Revenue increases are shown with a negative sign because they reduce the deficit.

b. Less than $0.5 billion.

There is a discussion in my statement about that. But I think the general outline and the details of the administration's budget are well known to this committee, and with your permission, I will skip over that portion of my statement.

APPROPRIATION CAPS

One part of our analysis that I would like to share with the committee this morning is that which pertains to the appropriation caps for national defense, international affairs and domestic programs that were embodied in the Budget Summit Agreement that the Congress and the President agreed to last November. These caps were also embodied in the reconciliation legislation that was passed last December.

Our comparison of the so-called discretionary appropriation caps, that were part of the Budget Summit Agreement, with the President's budget estimates, is presented in Table 7. As shown in the table, CBO finds that the budget comports quite well with the international and domestic discretionary caps but exceeds the defense outlay ceiling by about $500 million.

TABLE 7. DISCRETIONARY APPROPRIATIONS FOR FISCAL YEAR 1989 (In billions of dollars)

	Budget Authority	Outlays
Defense		
Bipartisan Agreement	299.5	294.0
President's Budget	299.5	294.0
Preliminary CBO Estimate	299.5	294.5
International		
Bipartisan Agreement	18.1	16.1
President's Budget	18.1	15.6
Preliminary CBO Estimate	18.1	16.1
Domestic		
Bipartisan Agreement	148.1	169.2
President's Budget	147.6	169.1
Preliminary CBO Estimate	147.3	168.3

SOURCES: Office of Management and Budget; Congressional Budget Office.

I might add, Mr. Chairman, that for us, a $500 million estimated difference for defense outlays is really quite small in comparison with the estimated differences that we have had in this area in the past. It is well within the estimated error range for these programs and cannot be viewed, I think, as a significant difference.

In compiling this table, however, a number of issues emerged that I want to bring to the committee's attention, since they will have to be resolved over the next month or so. In terms of the budget scorekeeping process, questions have arisen as to the proper treatment of several budget accounts—for example, the conditional advance appropriation for foreign military sales credit that was contained in the 1988 Continuing Resolution on appropriations; the payments to the Farm Credit System Financial Assistance Corporation, a new government-sponsored enterprise that was created late last year to rescue the farm credit system; and the Panama Canal Revolving Fund.

It appears that there are different ways of counting the amounts for these items against the Summit caps. The administration has done it one way; we have done it another way. These kinds of differences are not very large in dollar magnitude, but they can make a difference when scorekeeping is done against these caps.

SCOREKEEPING ISSUES

Various other types of scorekeeping issues have come up over the past year. We are working on a written set of scorekeeping rules and procedures, as requested by this committee. In doing so, we will work closely with the committee staff as well as with the other parts of the budget staff in the Congress over the next several months.

An example of a problem that needs to be resolved would be the classification of various budget accounts that are in appropriation bills as between those that are considered mandatory on the one hand and those that are discretionary on the other.

As I indicated, we are working with the committee staff and other Appropriations subcommittee staffs on the Hill trying to come up with a resolution to these various issues, and we hope that that can proceed in a good manner in the next couple of months.

Mr. Chairman, that concludes my statement this morning. With your permission, Mr. Chairman, I would like to ask two of my colleagues to join me at the table to assist in answering questions. Rosemary Marcuss is our Assistant Director for Tax Analysis and is responsible for preparing the revenue estimates that are contained in our analysis.

Chairman STENNIS. Suspend just a moment, please. You are going into another phase of this. We are glad you could come. You are always well informed. I think your statement here is not too long, but it is rather long. I think it ought to all go in the record.

Senator STEVENS. I agree, Senator.

PREPARED STATEMENT

Chairman STENNIS. All right. Without objection, then, we will put the entire printed statement that I am holding in my hand in the record. The lady understands that situation? All right. I wanted to get that covered before we got into another field.

[The prepared statement of James L. Blum follows:]

Statement of
James L. Blum
Acting Director and
Assistant Director for Budget Analysis
Congressional Budget Office

Mr. Chairman, at the request of this Committee, the Congressional Budget Office (CBO) has prepared an analysis of the President's budgetary proposals for 1989. I am pleased to appear before you this morning to summarize our findings. Our analysis will be described in detail in the CBO report titled *An Analysis of the President's Budgetary Proposals for Fiscal Year 1989*, which we plan to release on Thursday, March 10.

CBO estimates that the federal deficit under Administration policies would be $165 billion in 1989, $157 billion in 1990, and $109 billion in 1993 (see Table 1). These figures are considerably higher than the Administration's own estimates--$130 billion in 1989, $104 billion in 1990, and $23 billion in 1993. The lower panel of Table 1 divides the CBO reestimates of the Administration's budget into differences resulting from economic assumptions and those resulting from technical estimating methods. Most of the differences between the CBO and Administration estimates reflect assumptions about the future of the economy. CBO foresees less rapid real growth, higher inflation, and higher interest rates than does the Administration.

CBO analyzes the Administration's budget in terms of changes from the CBO baseline, which projects the course of the budget on

TABLE 1. CBO AND ADMINISTRATION ESTIMATES OF THE ADMINISTRATION'S BUDGET PROGRAM
(By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Estimates						
Revenues						
Administration	909	965	1,044	1,124	1,190	1,258
CBO	899	955	1,038	1,113	1,182	1,262
Outlays						
Administration	1,056	1,094	1,148	1,204	1,241	1,281
CBO	1,060	1,120	1,195	1,253	1,313	1,371
Deficit						
Administration	147	130	104	79	51	23
CBO	161	165	157	140	131	109
Differences in Estimates						
Revenues						
Technical	-3	-2	2	-1	a/	2
Economic	-7	-8	-8	-11	-9	2
Total	-10	-10	-6	-12	-8	4
Outlays						
Technical	1	9	14	1	6	1
Economic	3	17	33	48	66	88
Total	4	26	47	49	72	90
Deficit						
Technical	4	11	12	2	5	a/
Economic	10	25	41	59	75	86
Total	15	36	53	61	80	86

SOURCE: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.

a. Less than $500 million.

the assumption that current taxing and spending policies continue unchanged. CBO reestimates, or reprices, the Administration's budget using CBO's economic and technical estimating assumptions and methods. The differences between the baseline projections and the CBO estimate of the budget measure the effects of the Administration's proposed policy changes.

As in past years, the baseline budget projections assume that revenues, offsetting receipts, and entitlement spending are projected according to the laws now on the statute books. Defense and nondefense discretionary appropriations are assumed to be held constant in real terms. This year CBO has made minor changes in its baseline to make it identical to the budget base as specified in the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 (Public Law 100-119). We hope that this move will eliminate any confusion that resulted from having more than one baseline.

CBO's baseline budget deficits rise from $150 billion in 1987 to $161 billion in 1988 and $177 billion in 1989, before dropping to $170 billion in 1990. These baseline projections update those published last month in CBO's annual report, *The Economic and Budget Outlook: Fiscal Years 1989-1993*. The near-term revisions stem largely from an accounting change. In its 1989 budget submission, the Administration announced that the issuance of certain promissory notes by the Federal Savings and Loan Insurance Corporation (FSLIC) and Federal Deposit Insurance Corporation (FDIC) will henceforth be counted as budget outlays, just as FDIC demand notes have been treated as outlays since the 1988 budget. This accounting change adds $4 billion to outlays and the deficit in 1988 and $2 billion in 1989.

CBO ECONOMIC ASSUMPTIONS

CBO expects slower real growth, higher inflation, and higher interest rates during the next two years than does the Administration, as shown in Table 2. The CBO forecast, however, is similar to the consensus of private-sector forecasters. CBO projects that real gross national product (GNP) will grow by 1.8 percent in 1988 (measured

TABLE 2. CBO, ADMINISTRATION, AND CONSENSUS FORECASTS FOR 1988 AND 1989 (By calendar year)

	Actual	Forecast	
	1987	1988	1989
Fourth Quarter to Fourth Quarter (Percent change)			
Real Gross National Product			
CBO	3.8	1.8	2.6
Administration	3.8	2.4	3.5
Consensus	3.8	1.8	2.1
GNP Deflator			
CBO	3.3	3.9	4.2
Administration	3.3	3.9	3.7
Consensus	3.3	3.7	4.4
Consumer Price Index (CPI-W)			
CBO	4.5	4.9	4.8
Administration	4.5	4.3	3.9
Consensus	4.5	4.1	4.8
Calendar-Year Average (Percent)			
Three-Month Treasury Bill Rate			
CBO	5.8	6.2	6.7
Administration	5.8	5.3	5.2
Consensus	5.8	5.9	6.4
Ten-Year Government Note Rate			
CBO	8.4	9.3	9.5
Administration	8.4	8.0	7.4
Consensus a/	8.4	8.9	9.1
Civilian Unemployment Rate			
CBO	6.2	6.2	6.1
Administration b/	6.1	5.8	5.6
Consensus	6.2	6.1	6.2

SOURCE: Congressional Budget Office; Office of Management; Blue Chip Economic Indicators (February 10, 1988).

NOTE: The CBO forecast is based on the preliminary estimates of GNP for the fourth quarter of 1987 released in January 1988; the February revisions were small and are not included.

a. Averages are calculated by using CBO's projection of the difference between the corporate bond rate and the 10-year government note rate.

b. The Administration's projection is for the total labor force, including armed forces residing in the United States. In recent years, this rate has tended to be 0.1 to 0.2 percentage points below the civilian unemployment rate.

from fourth quarter to fourth quarter), the same as the consensus. This forecast reflects very slow growth in the first half of the year, followed by a rebound in the second half. The Administration, however, expects consistent 2 percent to 2-½ percent real GNP growth throughout 1988. In 1989, CBO expects real GNP to grow by 2.6 percent--somewhat less than the Administration forecast of 3.5 percent but above the consensus forecast of 2.1 percent.

Like most private forecasters, CBO expects both short- and long-term interest rates to rise over the next two years, while the Administration projects them to decline. In large part, these differences reflect different views about inflation. CBO expects consumer price inflation to accelerate slightly in the near term, as the fall in the dollar generates higher import prices, while the Administration assumes that inflation will decline.

Beyond 1989, neither CBO nor the Administration attempts to forecast the economy. Rather, both agencies make projections based on historical trends. As in the short-term outlook, CBO's long-run economic assumptions are less optimistic than those of the Administration but similar to those of major private-sector forecasting firms (see Table 3).

CBO BUDGET ESTIMATES

CBO's estimates of the deficit exceed the Administration's figures by $15 billion in 1988, $36 billion in 1989, and increasing amounts in

later years. In 1989, $25 billion of the $36 billion in reestimates is attributable to differing economic assumptions. In 1991 through 1993, virtually all of the reestimates are economic.

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Wharton	4,480	4,752	5,063	5,356	5,728	6,082	6,499
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Wharton	3,814	3,901	3,996	4,063	4,199	4,310	4,446
Real GNP (Percent change, year over year)							
CBO	2.9	2.3	2.6	2.6	2.6	2.7	2.7
Administration	2.9	2.9	3.1	3.5	3.4	3.3	3.2
DRI	2.9	2.0	3.2	3.0	2.2	2.0	2.0
Wharton	2.7	2.3	2.4	1.7	3.3	2.7	3.1
Three-Month Treasury Bill Rate							
CBO	5.8	6.2	6.7	6.6	6.4	6.1	5.9
Administration	5.8	5.3	5.2	5.0	4.5	4.0	3.5
DRI	5.8	5.3	6.0	6.3	6.3	6.2	6.2
Wharton	5.8	6.3	7.6	6.9	6.5	6.4	6.6
Ten-Year Government Note Rate							
CBO	8.4	9.3	9.5	9.0	8.4	7.8	7.4
Administration	8.4	8.0	7.4	6.8	6.0	5.0	4.5
DRI	8.4	8.1	8.4	8.6	8.6	8.7	8.7
Wharton	8.3	9.3	10.0	9.2	8.1	8.1	8.2
CPI-W (Percent change, year over year) a/							
CBO	3.6	4.5	4.9	4.6	4.4	4.4	4.4
Administration	3.6	4.3	4.1	3.6	3.2	2.7	2.2
DRI	3.6	3.9	4.6	4.9	4.7	5.0	5.2
Wharton	3.5	4.5	4.7	4.0	4.2	4.2	4.1

SOURCES: Congressional Budget Office; Office of Management and Budget; Data Resources, Inc. (February 2, 1988); Wharton Econometric Forecasting Associates (February 8, 1988).

a. CPI for urban wage earners and clerical workers.

Effects of Economic Assumptions

CBO's assumptions of lower real economic growth and higher interest rates tend to increase the estimated deficits, while its assumption of higher inflation tends to lower them, as shown in Table 4. Lower real economic growth holds down tax receipts, while increasing outlays for unemployment insurance and related programs. CBO's real growth assumption adds to the deficit in the President's budget by amounts growing from $7 billion in 1988 to $12 billion in 1989 and $67 billion in 1993. Higher interest rates increase debt service costs by $2 billion in 1988, $13 billion in 1989, and $52 billion in 1993.

Differences in inflation assumptions have little effect on the deficit estimates for the first few years, but CBO's higher inflation rates reduce the estimated deficits by $7 billion in 1991, $17 billion in 1992, and $33 billion in 1993. In the long run, faster inflation increases most revenue sources (by increasing taxable incomes and consumption) but raises only some outlay categories (primarily indexed benefit programs, Medicare, and Medicaid). CBO bases its estimates of defense and nondefense discretionary appropriations on the dollar amount of the Administration's request; it does not increase the request to take account of CBO's higher assumed inflation rates. If CBO's inflation assumptions prove correct, these appropriations will buy fewer real goods and services than the Administration now anticipates.

Effects of Technical Assumptions

Technical reestimates increase the estimated 1989 deficit by $11 billion, comprising $2 billion in lower revenues and $9 billion in higher outlays (see Table 5). Of the outlay differences, only a small portion involves discretionary accounts. Roughly $0.5 billion is in national defense programs, and slightly less than $0.5 billion is in nondefense discretionary appropriations. The nondefense discretionary differences are small because the Administration generally elected to use CBO estimates for these accounts. CBO's 1989 outlay estimates for deposit insurance, Medicare, and income security programs are each $2 billion higher than the Adminstration. Finally, CBO expects a total of $4 billion in lower proceeds from asset sales and loan prepayments.

TABLE 4. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S DEFICIT (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Lower Real Economic Growth	7	12	20	34	51	67
Higher Interest Rates	2	13	23	32	41	52
Higher Inflation a/	1	b/	-2	-7	-17	-33
Total Economic Reestimates	10	25	41	59	75	86

SOURCE: Congressional Budget Office.

NOTE: The figures include the changes in debt service costs caused by different borrowing.

a. Any effect of inflation on interest rates is included in the previous line.

b. Less than $0.5 billion.

Many of the same technical factors that increase the 1989 deficit also add to outlays in 1990. In addition, CBO believes that the first

TABLE 5. CBO REESTIMATES RESULTING FROM DIFFERENT TECHNICAL ASSUMPTIONS (By fiscal year, in billions of dollars)

	1988	1989	1990	1991	1992	1993
Revenues	-3	-2	2	-1	a/	2
Outlays						
National defense	2	1	a/	1	a/	-1
Nondefense discretionary appropriations	-1	a/	-3	-2	a/	1
Arctic National Wildlife Refuge leasing	0	0	2	-2	1	-1
Farm price supports	-1	a/	a/	-1	-2	-2
Deposit insurance	-1	2	1	a/	a/	-1
Postal Service	a/	a/	1	-3	-1	-3
Medicare	1	2	2	2	1	a/
Income security	a/	2	3	4	3	5
Net interest	2	a/	2	1	2	1
Asset sales and prepayments	-1	4	3	a/	a/	a/
Other	a/	a/	-1	0	2	1
Total Outlays	1	9	14	1	6	1
Total Technical Reestimates	4	11	12	2	5	a/

SOURCE: Congressional Budget Office.

a. Less than $0.5 billion.

auction for drilling rights in the Arctic National Wildlife Refuge (ANWR) could not occur before 1991; the Administration assumes that, if the Congress acts this year, leasing could begin in 1990. By increasing the deficit, the technical reestimates also increase interest costs by $2 billion in 1990. After 1990, technical reestimates are small in total.

THE ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the

Administration's budget program can be measured. Because the baseline and the CBO estimate of the budget employ the same economic and technical assumptions, differences between the two are solely the result of proposed policy changes. The Administration's budget would cut the projected deficits only modestly. CBO estimates that the Administration's budget proposals would reduce the 1989 deficit to $165 billion--$12 billion below the baseline level of $177 billion. The amount of deficit reduction remains $12 billion in 1990 and grows to $29 billion in 1993, as shown in Table 6.

The Administration's revenue proposals would reduce the deficit by about $1 billion per year. Additional revenues would be generated by requiring all state and local government employees to pay the Medicare tax and by repealing the scheduled reduction in airport and

TABLE 6. THE ADMINISTRATION'S BUDGET PROGRAM AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
CBO Baseline Deficit	177	170	159	154	139
Policy Changes					
Revenues a/	-1	-1	-1	-1	-1
National Defense	-1	b/	1	3	5
Nondefense Discretionary Spending	-2	-2	-8	-12	-16
Entitlements and Other Mandatory Spending	-3	-6	-6	-6	-6
Offsetting Receipts	1	b/	-4	-4	-6
Asset Sales and Prepayments	-6	-3	b/	b/	b/
Net Interest	b/	-1	-2	-4	-5
Total Policy Changes	-12	-12	-19	-23	-29
Deficit, President's Budget as Estimated by CBO	165	157	140	131	109

SOURCE: Congressional Budget Office.

a. Revenue increases are shown with a negative sign because they reduce the deficit.

b. Less than $0.5 billion.

airway tax rates. Proposals for more favorable tax treatment of research and experimentation spending, mutual fund expenses, and higher education savings bonds would reduce revenues.

For defense and nondefense discretionary spending, the Administration budget is guided by the appropriation caps contained in the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203). The CBO baseline projections do not reflect the 1989 savings from these caps, because these savings remain to be enacted. Instead, the baseline assumes 1989 appropriations based on the 1988 amounts adjusted for inflation of roughly 4 percent. The caps, in contrast, allow increases in budget authority of only 2.5 percent for defense and 2.0 percent for nondefense programs. By adhering to the appropriation caps, the Administration budget reduces defense outlays by $1 billion and nondefense discretionary spending by $2 billion in 1989 compared with the baseline.

After 1989, defense budget authority in the Administration's request would grow by 1 percent per year in real terms, based on CBO economic assumptions. The Administration claims a higher rate of real defense growth because of its lower inflation rate. CBO estimates that defense outlays would be close to the baseline amount in 1990 and would exceed the baseline by $1 billion in 1991 and $5 billion in 1993. Nondefense discretionary savings would remain at about $2 billion in 1990 and would grow to $8 billion in 1991 and $16 billion in 1993.

The Administration proposes few changes in entitlement and other mandatory programs. Entitlement reductions total $3 billion in 1989 and $6 billion per year thereafter. About a third of the reductions would be in Medicare, where the Administration proposes to lower reimbursement to providers. Reductions are also proposed in the veterans housing loan guarantee program, guaranteed student loans, Medicaid, and rehabilitation services.

Proposed changes in offsetting receipts would increase outlays by $1 billion in 1989, have little net effect in 1990, and reduce outlays by $4 billion in 1991 and $6 billion in 1993. The 1989 increase results primarily from a proposal to reclassify certain Customs Service fees as revenues rather than as offsetting receipts. Additional receipts would be garnered over the five-year period through raising beneficiary premiums for supplementary medical insurance (part B of Medicare), increasing Postal Service payments for employee retirement, and leasing rights to drill for oil in the Arctic National Wildlife Refuge.

Asset sales account for $6 billion, or half, of the 1989 deficit reduction. Slightly more than $3 billion derives from the prepayment or sale of loans made by the Rural Electrification Administration and other agencies. Sale of the Naval Petroleum Reserves and the Alaska Power Marketing Administration would yield somewhat less than $3 billion. Proposed asset sales contribute $4 billion to deficit reduction in 1990 and little thereafter.

APPROPRIATIONS ISSUES

The appropriation caps in the budget summit agreement have focused attention on the Congressional appropriation and budget scorekeeping processes. As requested by this committee, CBO is currently writing a manual of scorekeeping rules and procedures. But each year new issues will emerge that are not covered by existing precedents.

Assessing adherence to the appropriation caps has identified several such issues. Table 7 compares the appropriation caps contained in the bipartisan budget agreement with Administration and CBO estimates of the amounts in the President's budget. As shown in the table, CBO finds that the budget comports with the international and domestic discretionary caps but exceeds the defense outlay ceiling by $0.5 billion. The proper treatment of several budget accounts, however, is currently uncertain. These accounts include the conditional advance appropriation for the foreign military sales credit, clean coal technology, the conservation reserve program, payments to

TABLE 7. DISCRETIONARY APPROPRIATIONS FOR FISCAL YEAR 1989 (In billions of dollars)

	Budget Authority	Outlays
Defense		
Bipartisan Agreement	299.5	294.0
President's Budget	299.5	294.0
Preliminary CBO Estimate	299.5	294.5
International		
Bipartisan Agreement	18.1	16.1
President's Budget	18.1	15.6
Preliminary CBO Estimate	18.1	16.1
Domestic		
Bipartisan Agreement	148.1	169.2
President's Budget	147.6	169.1
Preliminary CBO Estimate	147.3	168.3

SOURCES: Office of Management and Budget; Congressional Budget Office.

the Farm Credit System Financial Assistance Corporation, the Panama Canal revolving fund, and the Internal Revenue Service. Until these issues are resolved, CBO's estimates of the discretionary appropriation totals are only preliminary.

The appropriations caps also raise several broader issues. For example, the existing Congressional scorekeeping system has difficulty dealing with annual appropriations that affect receipt accounts or permanent appropriations that are not in the spending jurisdiction of the Appropriations Committees. Similarly, the current cash-based treatment of credit programs not only paints a misleading picture of federal credit activity, as CBO has long argued, but also creates a number of knotty scorekeeping problems. Many proposals for credit reform, including the Administration's, would solve both of these problems. In the Balanced Budget Reaffirmation Act, the Congress asked CBO to study the budget's treatment of credit programs, and CBO will issue a report later this year.

Finally, the budget process is complicated by differences in scorekeeping practices between the Senate, the House, and the Administration. While considerable progress has been made in resolving many of these differences over the past two years, several others remain. The classification of accounts as discretionary or mandatory is a good example. These scorekeeping issues are not simply technical matters that can be left to CBO and the Office of Management and Budget to resolve. They will need to be addressed by the Appropriations and Budget Committees during the coming year. We look forward to assisting you in this endeavor.

INTRODUCTION OF ASSOCIATES

Chairman STENNIS. You were mentioning there you wanted to have someone there with you?

Mr. BLUM. Yes, Mr. Chairman.

Chairman STENNIS. Go ahead, then.

Mr. BLUM. I appreciate that. I was asking permission to have two of my colleagues here join me at the table to help me respond to any questions that you might have. Rosemary Marcuss is the Assistant Director for Tax Analysis and is responsible for preparing our revenue estimates. Mr. Jacob Dreyer is the Acting Assistant Director for Fiscal Analysis and is responsible for preparing the economic forecast that is so important in our analysis.

Chairman STENNIS. You wanted them to give a chance to supplement your testimony?

Mr. BLUM. No. I think it is just to help me in case you stump me with a question that I can't answer myself, so I could turn to them for assistance.

Chairman STENNIS. All right. What we want to do is to get at the facts. If you want to proceed in that way, that will be all right. We are glad to have you here with us. I know you will perform this serious business. All right, proceed.

Mr. BLUM. Mr. Chairman, that completes my opening statement. I would be quite pleased now to respond to any questions that you or Senator Stevens might have.

Chairman STENNIS. Senator Stevens, I call on you now? Do we have any more votes? Are you expecting more votes?

Senator STEVENS. No, sir. I have got all the time in the world. I will be happy to let you ask your questions, or I will ask some now. I do have lots of questions.

Chairman STENNIS. We will proceed in the usual way, and both of us will ask questions.

Senator STEVENS. Yes, sir.

Chairman STENNIS. All right. We will proceed here with some questions and alternate to other members when they come in.

ADHERENCE TO DISCRETIONARY CAP LEVELS

The President's budget purports to meet the discretionary cap levels for Defense, international and domestic programs which were agreed to by the Congress and the administration at last November's Budget Summit. Now, please give us your views as to whether these caps or levels have, indeed, been adhered to, and what were the major changes made by the administration in various programs to meet these levels?

Mr. BLUM. All right. The question goes to the issue of whether the administration has adhered to the appropriations caps that were in the budget summit agreement and were also embodied in the reconciliation bill of last year. Our analysis shows that, in almost all respects, the administration's budget does, indeed, conform to the budget summit agreement in terms of the targets for budget authority and outlays and for the spending categories of defense, international affairs and domestic programs.

The only exception, which I noted, is a slight difference, an estimating difference, in defense outlays for 1989. The difference amounts to about $0.5 billion, which, in terms of estimating differences that ,we have had with the administration in this area in the past, is exceedingly small and well within the error range that is to be expected in estimating defense outlays. I would not consider that as a significant estimating difference.

Chairman STENNIS. I want to make clear, I think that the work that we did last fall with all the different agencies of the Government cooperating: the Congress, the President, have given us a start. It ought to be subjected, though, to searching for an examination and to see where the soft spots are, if any, and that is what we want to get at here today.

You proceed, now, Senator, if you will, while I look at a matter or two here. Proceed.

ESTIMATING DIFFERENCES

Senator STEVENS. Mr. Blum, you say these are within the range of error as far as estimating differences. It seems to me, if I am right, we are talking about a $900 million error in domestic spending; is that right, and $500 million in defense? Is that your estimate? If you look on page 16, on your chart, your preliminary estimate is $168.3, and the bypartisan agreement was $169.2. The President's budget was $169.1. You are saying the President's budget is only $168.3? Is that the statement this chart makes?

Mr. BLUM. That is right. Senator.

Senator STEVENS. Am I right that you have an $800 million difference from the President out of $169.1 billion? Is that right?

Mr. BLUM. That is correct.

Senator STEVENS. Can you identify where you get the basis of that difference? What do you think was left out?

Mr. BLUM. As I indicated earlier in my statement, part of that difference can be attributed to different ways of scorekeeping against the Summit Agreement in terms of how particular accounts might work. Let me give you an example.

PANAMA CANAL OPERATING BUDGET

The Panama Canal operating budget last year was converted by the Appropriations Committee into a revolving fund, where the fees that are collected by the Government for ships going through the Canal are used to offset the operating costs for operating the Panama Canal.

The question is: How should that be scored against the summit agreement caps? Should it be scored on a gross basis, the total cost of operating the Canal, or should it be on a net basis, which is how the revolving fund appears now in the budget?

CBO scored the account on a net basis, because that is the way the account now appears in the budget. The Office of Management and Budget, on the other hand, scored the gross amount of the outlays. Now, we are talking about a $450 million difference between whether you do it on a gross basis or on a net basis.

That is an issue that I think has to be resolved between the participants to the summit agreement, the Appropriations and Budget Committees on the one hand and the administration on the other. But I wanted to highlight that to you as a difference.

302(b) ALLOCATIONS

Senator STEVENS. I don't have a lot of time. I know we are going to jump back and forth here. Others will be coming in. What you set off in this committee is a fight, again, on our 302(b) allocations. I am sure you realize that. We are going to now face a request to take $500 million out of Defense and, somehow or another, find an additional at least $300 million beyond that for domestic.

I don't, for one, understand how you can give us a different figure for Defense than the error in non-Defense, because the agreement was either one or the other, and you say that the President's budget is $500 million over on Defense, but it is $800 million under on domestic. Where are we going to get $300 million to start with? That is the number one question for this committee.

CHANGE IN CROSSWALKS

The number two question is: Do you really mean to imply to this committee that the crosswalks ought to be changed so that non-defense gets $500 million at least out of the Defense count? Is that what your presentation means? Have you thought about what you are doing here today?

We are the ones that make that decision, and we have had a fight every year for the last 5 years in crosswalks, and you are telling me that Senator Stennis and I, as two members on the Defense Subcommittee—He is the Chairman and I am the Ranking member—we are going to face a request now from the others to take at least $500 million out of Defense.

This budget has already been cut $30 billion-plus. So now we are going to have to cough up another $500 million. I am not sure you have thought about what you are doing here today. Do you intend to do what you are doing?

Mr. BLUM. What we have done is to simply apply our estimating methods and economic assumptions to the President's budget. This is what we have done for this committee for the past 7 or 8 years now.

Senator STEVENS. But you are leaving the impression that the President's budget leaves at least $800 million out of the domestic side of the Budget Agreement and puts $500 million more in the Defense side. That is what your statistics show.

I would like to ask you, if you will, Mr. Chairman, if it is proper, I would like to see documentation of that so when we have this argument, we can try to have an understandable argument or at least a basis for arguing.

Mr. BLUM. Yes. That will be documented in our complete analysis of the President's budget.

Senator STEVENS. Documenting it and having me have to spend time to dig it up is two different things. I want you to give us a list of where you believe that the President's budget is off on domestic and where it is over on Defense.

Mr. BLUM. We will do that.

Senator STEVENS. And pull it out so we can look at it and see what you are talking about and get their response before we get to this 302(b) crosswalk argument.

[The information follows:]

REESTIMATES OF THE PRESIDENT'S 1989 REQUEST FOR FUNCTION 050: NATIONAL DEFENSE

(By fiscal year, outlays in billions of dollars)

Account	1988	1989	1990	1991	1992	1993
President's 1989 Budget	285.4	294.0	306.2	320.2	335.4	351.3
Reestimates						
Military personnel	-0.1	0.4	0.5	0.5	0.5	0.5
Operation and maintenance	-0.4	0.4	0.2	-0.3	0.0	-0.1
Procurement	1.7	0.9	0.7	2.2	1.2	0.3
RDT&E a/	0.6	-0.7	-0.9	-1.2	-1.2	-1.3
Military construction	-0.1	-0.6	-0.4	-0.5	-0.4	-0.2
Family housing	-0.1	-0.2	-0.3	-0.2	-0.2	-0.1
Other	0.5	0.4	0.3	0.2	0.1	0.1
Total Reestimates	2.1	0.5	0.2	0.8	0.1	-0.7
President's 1989 Budget as Estimated by CBO	287.5	294.5	306.4	321.0	335.5	350.6

DIFFERENCES IN ESTIMATES OF NONDEFENSE DISCRETIONARY ACCOUNTS, FISCAL YEAR 1989 (In millions of dollars)

	Budget Authority	Outlays
PRESIDENT'S BUDGET AS ESTIMATED BY OMB	165769	184714
Conceptual Differences:		
Payments to the Farm Credit System (350)	-175	-175
Panama Canal revolving fund (400)	-449	-465
Subtotal, conceptual differences	-624	-640
Apparent OMB Classification Errors:		
Housing and other credit guaranty programs (150)	0	25
Inter-American Foundation (150)	0	-9
Special Defense Acquisition Fund (150)	0	-38
Colorado river basins power marketing fund (271)	0	-53
FHLBB limitation (370)	0	32
FSLIC (370)	0	2
Federal ship financing fund (370)	0	5
Rural housing insurance fund (370)	0	89
Business loan and investment fund (370)	0	-160
Operating differential subsidies (400)	-152	0
Ocean freight differential (400)	7	7
Rural development insurance fund (450)	0	68
Rural telephone bank (450)	7	*
Public broadcasting fund (500)	0	14
Medicare administrative expenses (570)	0	-35
Federal windfall subsidy (601)	-28	-28
Limitations on administrative expenses (601)	0	118
Rental housing assistance fund (604)	0	50
Low-rent public housing, loans and other exp. (604)	0	-135
Social security administrative expenses (651)	0	-182
Immigration user fee (751)	0	-6
Independent counsel (752)	-7	-7
Federal Prison Industries, Inc. (753)	0	10
OPM revolving fund (805)	0	-15
Payment to the District of Columbia (806)	20	5
Subtotal, apparent OMB classification errors	-153	-243
Estimating Differences:		
Export-Import Bank (155)	0	559
Space flight, control, and data (251)	0	-106
REA revolving fund (271)	-136	-8
NRC fees	-52	-46
Federal Energy Regulatory Commission (276)	53	54
Other energy (270)	0	-152
Conservation reserve (302)	0	144
Hazardous substance superfund (304)	0	-80
Rural housing insurance fund (371)	622	426
Railroad rehabilitation and improvement (401)	0	79
Federal-aid highways (401)	0	-194
Formula transit grants (401)	0	-135
Community development grants (451)	0	-41
Student financial assistance (502)	0	-122
Fund for AIDS research (552)	0	45
Subsidized housing programs (604)	0	286
Family support payments (609)	0	71
Social security administrative expenses (650)	0	-45
Other, net	-7	1
Subtotal, estimating differences	480	736
PRESIDENT'S BUDGET AS ESTIMATED BY CBO	165472	184567

NOTE: The proper treatment of several budget accounts under the appropriation caps is currently uncertain. Until these issues are resolved, CBO's estimates of the discretionary appropriation totals are only preliminary.

ESTIMATING DIFFERENCE IN PRESIDENT'S BUDGET

Senator STEVENS. Secondly, you say that you have now changed your estimates, and you have a $367 billion difference for 1989, which is the budget we have in front of us, right, in terms of the deficit projection?

Mr. BLUM. That is the estimating difference that we have in the President's budget.

Senator STEVENS. I know. This is a different subject now, all right?

Mr. BLUM. I understand. This does not really represent a change. It was clear when we presented our baseline budget projections last month that we had a very large estimating difference with the administration, largely due to the use of different economic assumptions. Our baseline deficit estimate for 1989 last month was $176 billion. We have revised that in March after looking at the President's budget and after learning of some changes that the administration has made with the deposit insurance programs.

Our estimate was $176 billion 1 month ago. The administration's comparable estimate was $143 billion. That was a $33 billion estimating difference. So already, in the baseline, we were $33 billion apart. Now what we are saying is that the estimating difference between us for the actual budget proposals, which contain a large number, a relatively large number, of policy changes, has grown to $36 billion. Most of that difference can be attributed solely to a difference in opinion as to how much various loan asset and real property sales and loan prepayments will bring to the government in 1989.

Senator STEVENS. The basic difference is in interest rates and a projection for growth. Twenty-five of the $36 billion is related to that, as I read your statement.

Mr. BLUM. That is exactly right, sir.

SCOREKEEPING RULES

Senator STEVENS. At your request last year, we mandated the OMB and you to get together on scorekeeping rules. Is there anything that comes out of scorekeeping rules that enters into either the two problems we have now: One, the problem of the Defense versus non-Defense or the other, your estimates of the 1989 deficit?

Mr. BLUM. The issue on scorekeeping rule differences is what we were bringing to the committee's attention. It has to do with some of these accounts like the Panama Canal Commission, in terms of how that should count against the caps.

Senator STEVENS. We are now asked to, in effect, arbitrate between you again. I remember one night 6 years ago, as a matter of fact, that we spent 3 nights, and we finally found out that the two computers that you all were using were not in agreement. We finally eliminated that problem, and now we are coming up with a different problem, and that is now you, notwithstanding the fact that you agreed you would have consistent scorekeeping rules, you are telling us you don't.

So we are now going to have to arbitrate and decide whether you are right or OMB is right on growth, on interest, and on the estimates that are reflected in terms of what is the percentage of $500 million out of $169 billion?

Mr. Dreyer. Point 3.

Senator STEVENS. The bipartisan agreement was .2, $169.2. What percentage are we talking about? They are all estimates, right? Every line on that is an estimate between you and them?

Mr. BLUM. That is right.

Senator STEVENS. And we come up with $500 million, and you present to the committee that problem. I can't understand you, frankly. Why haven't you gotten together with OMB?

FORECASTING OF ECONOMY

Mr. BLUM. The difference in the economic forecast is not new. We traditionally present to the Congress, in essence, a consensus type of forecast of the economy. The administration, regardless of who is in the White House, tends to present a more optimistic set of economic assumptions. The Congress is free to choose which set of economic assumptions it wishes to use in putting together its own budgetary plans.

That is not what I would call a technical difference to be left to technicians to resolve. That is a political judgment call, not something that should be left to the Congressional Budget Office or the Office of Management and Budget to resolve.

Senator STEVENS. My time is up. I will make one comment. You are right, except that this is the only committee in the Congress that, subject to a point of order, if it doesn't comply with the Budget Resolution, if the Budget Resolution reflects your point of view rather than OMB's, we will have to cut another half a billion dollars from Defense. And we will have to find $800 million somewhere for non-Defense. I think that is disservice to us in view of the Agreement we entered into last year.

I will wait for my time around again.

Chairman STENNIS. All right. Let me direct the attention now to a form of this part of this question, at least. I am going to suggest that we just state it in the record now and ask you to supply an answer to it as soon as you can, and we will go into another phase.

SEQUESTRATION TIMETABLE

The question is: Would you please set forth the sequence of events which will begin in mid-August and which will culminate in a final sequestration order by the President in mid-October? Would you also please explain to the committee the consequences of across-the-board cuts to the Defense and non-Defense programs which would be affected by such a sequester order?

As I understand the situation, that is a serious question, and to me, it sounds complicated and would have to have clear, explicit answers.

Mr. BLUM. Mr. Chairman, I would be happy just to spend a couple of minutes now responding to that question, if I may.

Chairman STENNIS. You would rather respond now?

Mr. BLUM. Yes.

Chairman STENNIS. All right. That would be entirely all right.

Mr. BLUM. Fine. The sequence of events now under the Balanced Budget and Emergency Deficit Control Act, as amended last year by the Congress, is as follows: On August 15, we and OMB both will take a snapshot of where the budget deficit stands for 1989 under some very detailed specifications set forth in the Balanced Budget Act.

Each agency is free to use its own economic assumptions in taking that snapshot. CBO will make an initial report on its findings on August 20. That report is sent to the Director of OMB and to the Congress. Under a change made last year, this report is an advisory report only. In the past it was a joint report with OMB, but there was a Constitutional defect in the original Balanced Budget Act as it was enacted, and that was corrected last year.

As a result, it is the report of the Office of Management and Budget now that governs totally the results of the sequestration process.

Their initial report will come out on August 25, and if a sequestration is in sight, in the sense that their estimate of the budget deficit exceeds $146 billion for 1989 at that time, then an initial sequestration order will be issued by the President.

CBO will issue a revised report on October 10, taking into account any legislation that has been enacted or regulations promulgated between August 15 and approximately October 10, or a date as near to that as possible.

OMB will issue its final report on October 15 and also a final sequestration order at that time if one is necessary. That is the sequence of events.

Right now, we see in the President's budget that OMB's estimate of what the deficit looks like now is $143 billion, which is just under the $10 billion error range that is allowed under the Balanced Budget Act. If that estimate by OMB holds come August, then there would be no sequestration. If, on the other hand, the economy does not perform as estimated, as forecast by the administration, between now and this summer, that number could well change; it could exceed the $146 billion margin.

Chairman STENNIS. Senator Hatfield, you haven't had a chance to ask questions. We are delighted you could be here, and you just proceed, if you wish now.

Senator HATFIELD. Thank you, Mr. Chairman. The 10-minute rule is in effect?

Chairman STENNIS. Well, we really haven't enforced it.

Senator HATFIELD. I have a lot of questions, but I want to comply with your wishes.

Chairman STENNIS. We called on Senator Stevens. I hadn't announced whether we were under it or not. I will just let it go.

Senator HATFIELD. I will be conscious of brevity.

Chairman STENNIS. You go ahead. I want to hear your questions. Proceed.

ECONOMIC GROWTH PROJECTIONS

Senator HATFIELD. Mr. Blum, the Congress has criticized the administration on numerous occasions on the matter of sending up budget forecasts which we have felt were overly optimistic as far as the economic assumptions that have been observed, and some have expressed that concern about this year's budget in considering the budget we are considering now.

The testimony of Secretary Baker, Secretary of the Treasury the other day, indicated that the administration had underestimated economic growth for 4 of the last 7 years. I would like to get this in the context as to the record of the CBO. How close have you been in this 7-year period on these economic predictions, and do you have reason to believe that the forecasts that you make as far as coming years are concerned are more accurate than the OMB forecast?

I am not playing "sic 'em" between OMB and CBO, but for those of us who are laymen trying to struggle with baselines and so forth, this is a very important issue for the appropriations process.

Mr. BLUM. I understand, Senator. The first comment that I would have to make is that economic forecasting is certainly an imprecise science, at best, and there is lots of uncertainty involved and lots of room for making errors.

In looking back over the past, neither the administration nor CBO has been substantially less accurate than private sector forecasts. It all depends on the variable that you are looking at; lots of points could be tallied for being closer on this variable or closer on that variable. I think over the period, though, in looking back, no one source has consistently produced the most accurate forecast of all the key indicators that go into making the budget assumptions.

This view, actually, was that of the General Accounting Office in its review of the forecasting records of OMB and CBO and the private forecasters over the last several years. What one sees when one looks at a comparison of the forecast errors is that most of the errors tend to be in the same direction at any one point in time; all forecasters have a very difficult time in seeing turning points in the economy, for example.

We all tend to be surprised by the same events. In the end, I don't think much is to be gained by trying to hold one source up as being superior in all respects to another.

I must say, in looking at our forecasts for both the near term and the longer term, that the administration's forecast for 1988 is a very reasonable one and well within the range of forecasts that have been made.

There is an awful lot of uncertainty and diversity of views, particularly as to the effects of the stock market collapse, or however it should be referred to, in October. For 1988, the administration's forecast is clearly a reasonable one.

Now, in 1989 and in the out-years, there is increasing divergence between the CBO forecast and the administration's forecast. Our forecast tends to be much closer to the consensus of private forecasters for 1989, and increasingly so in the out-years. These differences cumulate and magnify the estimating differences that we have for these budget deficits for the out-years.

FORECAST FOR 1988

Senator HATFIELD. Let's take your fiscal year 1989–93 forecast. Let's talk about the out-year forecast. In the document that you have submitted to the Congress, you indicated that, and predicted, and I believe the phrase you used was a "pronounced slowdown" in growth early in 1988. My question is: Are there any positive economic indicators that would cause you in any way to modify that or, more precisely, are we now in that pronounced slowdown in growth? Is it upon us? This is early 1988.

Mr. BLUM. Well, Senator, it appears, particularly with this morning's announcement on the unemployment rate, that this pronounced slowdown that we were expecting, particularly in the first quarter, is not materializing; that things are quite strong in terms of the unemployment rate dropping, in February, to 5.7 percent, down one-tenth of 1 percent from the January level; employment was up.

We also see that interest rates are relatively low, at least in comparison with our forecast. The decline in the dollar has not been as sharp as we forecast; actually, the dollar has been much stronger so far in the first 2 months than we expected.

Part of that may be the result, however, of very large purchases of dollars by central banks of foreign countries that are being made, perhaps, to support the price, the value of the U.S. dollar.

INFLATION

On the inflation front, things are ambiguous. Oil prices are clearly lower; they have gone down from the level that we had expected when we made this forecast, which, I must point out, was essentially in December. So we have had 2 months of results since that time. I guess, coming back to the initial question about the slowdown that, in the first quarter, appears not to be happening, we do think that there could be a weakening in the near future. There is a large overrage of inventories that have accumulated in the latter part of the last calendar year, which could mean a flattening of production. So I think it is too early to tell exactly how the rest of the year will work out.

Senator HATFIELD. Do I hear you saying that you would amend that statement from a pronounced slowdown early in 1988 now to a pronounced slowdown late in 1988?

Mr. BLUM. It may not be pronounced. It may be that the slowdown was slower than we thought, and it may be postponed a quarter of so.

PRODUCTIVITY RATE

Senator HATFIELD. One last question for the moment, and then I will yield the floor. Let me ask you, on the basis of the administration's forecast, they incorporate an assumption or a prediction, whatever you want to call it, that the productivity rate would average 2 percent per year for the next 5 years.

Based upon the record of the past, where I believe that was a point of reference in that record was 1973 for a span of years, was less than 1 percent, and then for the more recent period of that span of time, from 1978, it has been a little over 1 percent. How would you analyze that assumption of 2 percent growth? Is it a realistic assumption, or a prediction, or is it just a hoped-for goal? What is the reality of that 2 percent productivity increase?

Mr. BLUM. Reality is very difficult to perceive, but you are correct in pointing out that a key assumption for the administration's longer-run real growth assumptions is a relatively high growth in productivity. It is at the average since World War II, but does represent an increase from what has been experienced more recently.

Whether or not it is real, I don't know. Perhaps my colleague Mr. Dreyer, can say.

Mr. DREYER. Thank you. Essentially, it depends on which period you choose for your average. Certainly, there is good reason to expect future productivity growth to be higher than it has since 1973, because the oil shortage is over; because we will have, probably, a rise in merchandise exports as we close our trade deficit, and that export surge will be concentrated mostly in manufacturing where productivity gains are easier to come by than in the service sector.

There are certainly reasons to expect productivity growth to be higher over the next several years than we have experienced since 1973. I would like to be more precise with the number, but it is not possible to predict. It has got to be, as you say, surmised or assumed, and we believe that the entire post-World War II period is vastly relevant to estimating productivity gains in the 1990s.

TREND LINE IN 1981–87 PERIOD

Senator HATFIELD. What is the trend line in that 1981 to 1987 period? They show a 1.5 to 1.6 productivity growth.

Mr. DREYER. That is correct.

Senator HATFIELD. Is that weighted, or should that be weighted in the more recent part of that period, or does that affect the basic outcome?

Mr. DREYER. If I understand you, Senator, you are asking: Is it a moving average? It is not a moving average. It is a straight average.

Senator HATFIELD. A straight average?

Mr. DREYER. A straight average. Yes, every year is identically weighted. The most recently posted is not given increasing weight, as it would be in a moving average. It is difficult to talk about the trend over such a brief period of time. We had a major recession in 1981 and 1982, and, of course, productivity rises very sharply cyclically during a rebound from a recession.

This expansion, as we well know, has lasted since 1982. We expect that the trend, in the sense of a cyclical trend, is distorted by the cyclical movements of the 1980s. I frankly do not know whether there has been some sort of an increase in productivity, or in an explainable component of productivity, in the 1986 to 1987 period as compared to 1983, say, and 1984. But even if I knew, I would not put too much faith in those numbers.

Senator HATFIELD. What would you put in that slot on a reasonable predictable increase in productivity, say, over the next 5 years? If not the 2 percent, what would you put in there?

Mr. DREYER. I would say, of course, that our projections are reasonable projections, but it is very difficult to make a reasoned distinction, let's say, between a 1.3 percent increase and a 1.8 percent increase.

Senator HATFIELD. How is that?

Mr. DREYER. Between 1.3 percent a year and 1.8 percent a year anything can happen. And of course, along with that, the rate of growth of real GNP would increase almost commensurately.

Senator HATFIELD. That range is for the total finding?

Mr. DREYER. That is correct, and that is very difficult to estimate with any precision, partly because the economy is so specialized. Secular productivity trends in various sectors differ by much more than one-half of 1 percentage point per year.

BUDGETARY GOAL TARGETS

Senator HATFIELD. Could you translate that 2 percent into your economic assumption as to, then, what the range of off-target would be for the dollars that we are dealing with in that period of time? For instance, it reaches, say, your area of 3 to 8 percent rather than the 10 percent. That could put the target of this whole budgetary goal and expectation, really, off quite a considerable amount on the dollars, couldn't it?

Mr. DREYER. I cannot compound this over 6 years in my head, Senator, but you are certainly right. It adds up to meaningful differences in real GNP assuming the same inflation rate and the same nominal GNP and the same tax base until you ultimately come to the deficit. If you wish, we can make the proper computations with one-half or 1 percentage point changes in productivity and estimate the effect of different rates of productivity increase over the next several years on the budgetary aggregates.

Mr. BLUM. Senator Hatfield, in our statement this morning, we did point out the budgetary consequences of the lower real economic growth that CBO is assuming in comparison with the administration, and you are quite correct. Over time, these differences loom quite large.

Senator HATFIELD. Thank you, Mr. Chairman.

Chairman STENNIS. Thank you. Thank you, Senator. Senator Burdick, that brings it to you, sir.

DEFINITION OF EMPLOYMENT

Senator BURDICK. I don't have any questions. I have one small question, however, that is tantalizing me a bit. What is your definition of an employed person?

Mr. BLUM. In terms of the numbers of hours a week?

Senator BURDICK. In terms of hours; use that definition for me, please.

Mr. DREYER. I think that people who draw unemployment insurance are unemployed people. That is not based on employment.

Mr. BLUM. Yes.

Senator BURDICK. Can you give it to me in hours? If a man is employed 20 hours a week, is he employed statistically?

Mr. BLUM. I think that would be counted as part-time.

Mr. DREYER. I am informed here that it includes part-time, as well.

Senator BURDICK. How much time does part-time go, 10 hours, 15 hours?

Mr. DREYER. You are nailing me. I just don't know.

Senator BURDICK. You are the one that is supposed to know the statistics.

Mr. DREYER. I know the statistics. I am just not clear on every definition. But we can very easily find it out.

Senator BURDICK. But you are certain that a 20-hour a week employee is considered employed?

Mr. DREYER. It would be an employed person, yes.

Senator BURDICK. How much below you are not prepared to say at this moment.

Mr. BLUM. We would have to look that up and get back to you.

Senator BURDICK. I would like to know this for my own information.

Mr. DREYER. It is the Bureau of Labor Statistics that sets the amount of hours. Twenty hours is employed. Whether 19 hours is, and so on, I don't know.

Mr. BLUM. It says, and I am reading from the latest release this morning for the results for the month of February, that people are classified as employed during that month if they did any work at all as a civilian; worked in their own business or profession or on their own farm, or worked 15 hours or more in an enterprise operated by a member of their family, whether they were paid or not. People are also counted as employed if they were on unpaid leave because of illness, bad weather, disputes between labor and management or for personal reasons. The members of the Armed Forces stationed in the United States are also included in the employed total.

Senator BURDICK. I understand from that that if a man is employed for 15 hours he is employed?

Mr. BLUM. If he is working in an enterprise operated by a member of his family, but it sounds as though if he was working in a paid capacity for someone else for an hour that would count as employed.

Senator BURDICK. If A worked for employer B one hour, he is employed?

Mr. BLUM. That is the inference that I draw from what I just read, Senator.

Senator BURDICK. I learned something. Thank you.

Chairman STENNIS. Are you through?

Senator BURDICK. I am through.

ASSET SALES AND LOAN PREPAYMENTS

Chairman STENNIS. I have a question here regarding these loan asset sales and so forth. The President's budget proposes various loan asset sales and pre-payments which are estimated to generate proceeds of $8.5 billion and real property sales which are expected to generate proceeds of $3.5 billion.

Please review for the committee the various items which the administration wishes to dispose of and what their effect will be on both deficit reduction and meeting this year's targets under the revised Gramm-Rudman-Hollings law.

That attracted my attention here, of course, because my observation is generally that you don't reap that much money on these different kinds of properties. It doesn't turn back in; it doesn't generate the proceeds of that amount. What is your answer to that? I more or less challenge this on the facts. What is your answer?

Mr. BLUM. Yes, sir.

Chairman STENNIS. It is important, I think, what you think about it.

Mr. BLUM. What you have pointed out, Mr. Chairman, is that the administration's budget for 1989 does contain proposals that assume a relatively large amount of asset sales and loan prepayments. The total of what you cited, $8.5 billion in loan asset sales, pre-payments, and another $3.5 billion in real property sales, adds to $12 billion.

Most of that would not count under the Gramm-Rudman-Hollings law as a deficit reduction; at least $10 billion of that $12 billion would not count. One can also point out that our estimates of what these transactions would bring are somewhat lower than the administration's. In fact, our estimate is that instead of $12 billion in cash proceeds being generated during 1989, we would get only something like $7.5 billion.

Let me just summarize some of these transactions for you. In the loan assets and loan prepayment category, the major items include the various loans that have been made by the Rural Electrification Administration for rural electric systems and telephone systems. The administration estimates something like $2.1 billion for the proceeds from the sale of these loans or from early prepayment. The CBO estimate for these proceeds is $500 million lower, or $1.6 billion.

Another large area of loan prepayments that is included in the administration's estimate for 1989 has to do with prepayment of various military sales credit loans that have been extended by the Federal Financing Bank. Authorization for this is included in the 1988 continuing resolution of appropriations. The administration assumes that $2.3 billion of these loan prepayments would occur in 1989. CBO, on the other hand, believes that to the extent that these prepayments will be made, they will all be made in 1988, soon after the regulations are issued; as a result, we don't see any receipts coming in from this area in 1989.

In the area of real property sales, perhaps the largest is the selling of the Naval Petroleum Reserves. This is at Elk Hills in North Dakota, I believe, and in California. The administration estimates that the sale of these properties would raise $3.2 billion in receipts. The CBO estimate is somewhat lower, at $2.5 billion.

There are also other asset sales and prepayments that are proposed. Again, the CBO estimates offer somewhat lower receipts.

Chairman STENNIS. All right, sir. Were you finished?

Mr. BLUM. Yes.

Chairman STENNIS. Do you have any more questions?

Senator BURDICK. No, thank you.

DEFENSE ACCOUNT TRANSFERS

Chairman STENNIS. Excuse me just a minute. Let me check into a matter. I have a question here. I understand the administration will propose a supplemental appropriations request to change transfer authority and alter foreign currency fluctuation authority for the Defense Department. Has CBO examined these matters and estimated what the outlay impact will be of these changes? I want to make clear that there is no tactic.

This is not framed up as a question to be tactical. We had an agreement last year, and I favor it highly and strongly and want to follow it to the letter of the law, the letter of the figures, as far as we can. So I want to know about that. Is that question clear?

Mr. BLUM. Yes, it is, Mr. Chairman.

We have made a preliminary analysis of the proposal, as we understand it. I think Secretary Carlucci spoke on the subject yesterday before the Senate Budget Committee. Based on that testimony and the items that he outlined yesterday that would be subject to the transfer, we would estimate that increasing the transfer authority to $4 billion for 1988 from the $1.5 billion that was provided in the continuing resolution of appropriations would actually raise outlays in 1988 by $1.9 billion. It would have the effect of lowering outlays in 1989 by, by our estimate, about $0.6 billion.

Transfers would be made from various slow-spending accounts to the faster-spending accounts for the kind of items that the Secretary indicated were in need of additional funds. One of the largest transfers is to account for foreign currency fluctuations, because the costs of maintaining our Armed Services abroad have grown as a result of the falling value of the dollar. There are a number of other items, all of which are relatively fast spending.

The monies that would be transferred would result in increased outlays in the receiving accounts. The areas that they would be transferred from would produce some outlay reductions, but by no means of the same magnitude.

RESTORATION OF EXPIRED BALANCES

With respect to the legislative proposal that the Department is making for the restoration of expired balances to be put into the foreign currency revolving fund, it is clear that this would, from a scorekeeping point of view, have to be regarded as a reappropriation; that expired amounts, when they are resurrected and made available, are the same thing as a reappropriation. It is the equivalent to your committee of making a new appropriation. That would be scored as budget authority, and the use of that money would also result in outlays.

Based on some informal data that we have gotten from the Department of Defense, we would expect that DOD would restore as much as $1.6 billion of expired balances in fiscal year 1988, which could result in an equal amount of outlays.

Chairman STENNIS. Do you wish to add anything on any point that you have been asked about? We are about ready to conclude here, but we don't cut anybody off. Do you want to add a point or anything like that from those that you have raised?

Mr. BLUM. I appreciate the opportunity, Mr. Chairman, but I don't believe I have anything further to add.

Chairman STENNIS. I have two questions here along the lines of others that I would like to contribute and put them together and file for the record. You can give it your attention when you give other matters attention.

Senator, you got here just in time.

Senator GRASSLEY. I suppose I am just like the skunk at the Sunday school picnic: I came in at the wrong time.

Chairman STENNIS. Go ahead.

Senator GRASSLEY. Very quick. Mine won't take very long.

Chairman STENNIS. You are recognized. All right.

Senator GRASSLEY. You were very good to me the last time you were before another committee, so I don't have anything detailed, but I get to this argument or start out with this argument: We always have Congress blaming the White House and the White House blaming the Congress for these high deficits.

COMPARISON OF PROPOSED AND ACTUAL BUDGET TOTALS

I wonder if you could, and you might have to do this in writing, though, because it is fairly detailed, but I wondered if you could provide us with a very simple analysis of each of the following numbers for the fiscal years 1976 through 1989. This would be along the line of an analogy that Senator Domenici did a few years ago, A, B, C. A, the President's proposed spending total and deficits as priced by CBO for the coming fiscal year as compared with B, the proposed spending and deficit totals as reflected in the conference report of the final concurred budget resolution, and C, as compared with the actual spending and deficit totals for each of those years.

I would appreciate, though, if you have any general insights along that line that you could give me right now, I would appreciate it. My assumption is that you are going to see the President and the Congress very close to their estimates of both spending and deficits, but I think that I hope what we see is that Congress actually did a little bit better than Presidents have over this period of time.

Mr. BLUM. I suspect that that might be the result. We will be glad to pull this together. Of course, you are aware that we have done this analysis essentially in response to your interest in this area in preparing the congressional budget targets, to help clarify why these large differences in the deficits occur.

What you are suggesting, it seems to me, is for us to add the President's budget to that analysis.

Senator GRASSLEY. Yes.

Mr. BLUM. We will be happy to do that. I don't know that we can go as far back as 1976, however. Would it be sufficient if we went to 1980, which is the period covered by this analysis?

Senator GRASSLEY. The only reason I was suggesting 1976 is I think that was the first year of the real impact of the Budget Act of 1974, wasn't it?

Mr. BLUM. Well, that is true, but our analyses of these differences really only began for fiscal year 1980. Also, what we have been doing for many years now is repricing the administration's budget with ours. We actually didn't begin as early as the 1970s. I think we started that around 1980, if memory serves me correctly.

Senator GRASSLEY. Okay. Let's just leave it this way. Go back as far as you can. If it is going to be real difficult to go back to 1976, just have somebody on your staff get hold of my staff and see what we can arrive at, if there is anything useful back then.

Mr. BLUM. All right. We would be happy to do that, sir.

[The information follows:]

Comparison of Budget Totals Under President's Budget Proposal and
First Budget Resolution, Fiscal Years 1980-1987
(in billions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
President's Budget								
Outlays	540.0 a/	622.9 b/	695.3 c/	779.3 d/	840.8 e/	937.6 f/	972 g/	1009.7 h/
Revenues	499.4 a/	603.5 b/	650.3 c/	657.1 d/	669.9 e/	748.7 f/	793 g/	849.9 h/
Deficits	40.6 a/	19.4 b/	45.0 c/	122.2 d/	170.3 e/	188.9 f/	179 g/	159.7 h/
First Budget Resolution								
Outlays	532.0	613.6	695.4	769.8	851.2 j/	932.0	967.6	995.0
Revenues	509.0	613.8	657.8	665.9	679.6	750.9	795.7	852.4
Deficits	23.0	-0.2 i/	37.6	103.9	171.6 j/	181.2	171.9	142.6
Actuals								
Outlays	579.6	660.5	728.4	796.0	841.8	936.8	989.8	1004.6
Revenues	520.1	602.6	617.8	600.6	666.5	734.1	769.1	854.1
Deficits	59.6	57.9	110.7	195.4	175.3	202.8	220.7	150.4

Note: The President's budget has been adjusted for comparability with the budget resolutions. Data for 1980-1985 exclude formerly off-budget items, such as the Federal Financing Bank. Data for 1986-1987 include Social Security revenues and outlays, which are off-budget.

a. Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1980*, January 1979.

b. Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1981*, February 1980.

c. Office of Management and Budget, *Fiscal Year 1982 Budget Revisions*, March 1981, p. 11.

d. House Budget Committee, *First Concurrent Resolution on the Budget--Fiscal Year 1983*, June 7, 1982, p. 17.

e. Congressional Budget Office memorandum dated June 22, 1983.

f. House Budget Committee estimate, September 1984, using budget resolution assumptions.

g. Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1986*, February 1985, using Office of Management and Budget (budget resolution) economic assumptions and Congressional Budget Office technical assumptions.

h. Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1987*, February 1986.

i. Surplus.

j. Adjusted for enactment of reserve fund programs.

CONCLUDING REMARKS

Senator GRASSLEY. Mr. Chairman, that is all I have.

Chairman STENNIS. You are finished?

Senator GRASSLEY. Yes.

Chairman STENNIS. All right. We are glad you could get here.

Is there any other point you want to cover at this time? We may recess or we may adjourn for the day.

Mr. BLUM. No.

Chairman STENNIS. Is there any point you want to cover?

Mr. BLUM. No, sir. I wish to thank you again for having us here this morning to present the results of our analysis to the committee.

Chairman STENNIS. All right. Does anybody have in mind any member that is on his way here now? None that we know of. We want to thank you and those that contributed with you for your attention here today at the time. You may be called on for more information. This is a very important matter, the whole issue is.

SUBMITTED QUESTIONS

We thank you again for your attention and for coming today and so forth. This record will be available for you as soon as the lady can get it completed. You have nothing further? You have to think for the Committee. You have got to find a solution to this matter; I mean the budget matter. Your help is appreciated. Thank you very much. I have two sets of questions here from members. I ask unanimous consent that they be admitted into the record for the attention of you gentlemen and the lady also will report them. Those are from Senator D'Amato and Senator Inouye. All right, they will be placed in record. Thank you very much. I appreciate your attention and your help.

[The following questions were not asked at the hearing, but were submitted to CBO for response subsequent to the hearing:]

QUESTIONS FROM SENATOR STENNIS

Outlay Estimates

Question: I understand there is a difference in defense outlay estimates between CBO and the Administration in the fiscal year 1989 budget. Can you explain the difference and why it has occurred?

Answer: CBO reestimates are aimed at providing CBO's technical appraisal of the budget impact of Administration policies. Given the Administration's policies, outlays for defense programs will total $294.5 billion in 1989--$0.5 billion higher than the outlay total in the Administration's budget and the budget summit. This difference should not be viewed as significant; it is well within the normal statistical error of outlay estimating. Outlays under the Administration's program could be higher or lower than CBO estimates by billions of dollars--but, because total defense budget authority has been relatively stable since 1985, the error in current estimates is probably less than $6 billion or plus or minus 1 percent.

The table shows that CBO has higher outlay estimates than the Administration in some categories and lower estimates in others. In making its outlay estimates, CBO uses historical spendout rates including an allowance for estimated lapses--appropriations that will never be spent. There is much room for error in estimating how much of an appropriation will spend in a given year and how much will never be spent; in many cases these are analytic judgments over which people can differ. For each of the categories shown in the table CBO has attempted to have the same probability of underestimating outlays as of overestimating them.

REESTIMATES OF THE PRESIDENT'S 1989 REQUEST FOR FUNCTION 050: NATIONAL DEFENSE (By fiscal year, outlays in billions of dollars)

Category	1988	1989	1990	1991	1992	1993
President's 1989 Budget	285.4	294.0	306.2	320.2	335.4	351.3
Reestimates:						
Military personnel	-0.1	0.4	0.5	0.5	0.5	0.5
Operation and maintenance	-0.4	0.4	0.2	-0.3	0.0	-0.1
Procurement	1.7	0.9	0.7	2.2	1.2	0.3
RDT&E a/	0.6	-0.7	-0.9	-1.2	-1.2	-1.3
Military construction	-0.1	-0.6	-0.4	-0.5	-0.4	-0.2
Family Housing	-0.1	-0.2	-0.3	-0.2	-0.2	-0.1
Other	0.5	0.4	0.3	0.2	0.1	0.1
Total Reestimates	2.1	0.5	0.2	0.8	0.1	-0.7
President's 1989 Budget as Estimated by CBO	287.5	294.5	306.4	321.0	335.5	350.6

SOURCE: Congressional Budget Office.

Question: I was under the impression that CBO and OMB were going to use the same measurement for outlay estimates for all government spending in compliance with the Budget Summit agreement. Why has the CBO deviated from this practice?

Answer: The summit agreement provided that CBO estimates would be used for scoring discretionary accounts. During January 1988 CBO and OMB staffs worked together to resolve estimating differences for nondefense discretionary accounts. In the budget, OMB used CBO estimates for all but about two dozen nondefense discretionary accounts. OMB decided, however, not to use CBO estimates for national defense programs.

Question: Under whose outlay rates will a Defense Appropriations bill be scored in order to measure compliance with the Budget Act, those of OMB or CBO?

Answer: Appropriation bills are always scored under the Congressional Budget Act in a manner consistent with the assumptions used for the annual budget resolution. Which outlay rates will be used, therefore, depends upon which rates are used for the budget resolution. We would look to the Budget Committees for guidance on this point. I might add, Mr. Chairman, that under the Budget Act, it is the Budget Committees who have the ultimate responsibility for making the budget estimates for determining whether bills are in compliance with a budget resolution.

Question: What historical evidence or other factors can you provide which clearly demonstrates that your methodology is superior to that used by OMB to justify your deviations from the defense outlay rates used by the Administration?

Answer: CBO's higher estimate for 1989 is rooted in its higher estimate for 1988. CBO estimates that national defense (function 050) outlays in 1988 will total about $287.5 billion--$2.1 billion more than estimated by the Administration. This estimate is consistent with recent reports from the Department of Treasury which showed 1987 outlays to be $1.5 billion higher than CBO previously estimated and which show very strong defense spending for the first five months of the current fiscal year. A year-over-year extrapolation for 1988 shows outlays totaling about $288 billion for only the Defense Department's portion of the national defense function, and time series projections show an amount slightly higher than that. This compares with the OMB estimate of $277 billion for 1988 and CBO's estimate of $279 billion, and suggests that both the Administration and CBO may have underestimated Defense Department outlays for 1988 by several billion dollars.

Outlay estimating has inherent error and it is almost certain that the Administration's and CBO's estimates will differ from the actual result at the end of a fiscal year. Nevertheless, since 1982 CBO has had a slightly better estimating record than the Administration for defense outlays. The average error of the CBO estimate has been about $1.0 billion compared with about $1.4 billion for the Administration. In terms of the average absolute error, the CBO estimate missed the actual by about $3.2 billion compared with about $3.9 billion for the Administration.

Scoring Outlays

Question: Mr. Blum, I understand that in the past the CBO has scored neither general transfer authority in Defense Appropriations bills nor foreign currency fluctuation usage as impacting outlays. If you intend to do so in the fiscal year 1988 supplemental, please explain why it is appropriate to do so given the preceding scoring of similar provisions in Defense and Supplemental Appropriations Acts.

Answer: We have not scored outlays when an appropriation bill contains general transfer authority because at the time we have not had information that outlays would be affected in any significant way. We assume that any significant imbalances in budget authority would have been addressed in the bill itself rather than being left to the Administration's discretion in the form of transfer authority. When we have evidence that the Administration will use the authority and how it will be used, CBO adjusts its outlay scoring. For example, when CBO saw in the Administration's current request that funds had been transferred out of procurement accounts and into operation and maintenance accounts, we raised our outlay estimate for 1988 accordingly.

This year the Administration is requesting an increase in the transfer authority for 1988 and Secretary Carlucci has testified that the authority would be used to fund increased costs in certain fast-spending accounts. Given that the Defense Department acknowledges uncontrollable cost growth in fast-spending accounts and is actively seeking greater transfer authority, it is clear that the transfer authority will be used and that it will be used to transfer funds from relatively slow-spending accounts to fast-spending accounts as the Administration has already done with its existing transfer authority. Unless there are compensating outlay reductions in other accounts, we would expect such transfers to result in higher outlays.

The Administration may also seek legislation to ease the adjustment to currency fluctuations by broadening the revolving fund for currency fluctuations. Under current law the fund can be drawn down by the O&M accounts when the dollar depreciates, but is replenished by the O&M accounts when the dollar appreciates. The current balance in the revolving fund is very low, so the Administration is seeking legislation allowing all DoD expired unobligated balances to be transferred to the revolving funds for subsequent withdrawal by not only the O&M accounts but also by the military personnel accounts. A similar proposal may be made for a currency fluctuation account for military construction.

This proposal would raise both budget authority and outlays in 1988 and later years. It would raise outlays in 1988 because funds that would never be spent in the original account would be spent in O&M. (For example, under current law the DoD loses the authority to obligate and spend some procurement funds after a certain number of years, but under this proposal the DoD would be given a second opportunity to spend the funds after they had been transferred to the foreign currency revolving fund.) Also, this proposal would raise budget authority in all years as funds are "reappropriated" from their original purpose to the new purpose of capitalizing the foreign currency fluctuation revolving fund.

Prcposals like this were enacted in the 1983 and 1987 defense appropriation bills. With the 1983 bill, the currency fluctuation account was allowed permanently to receive expired unobligated balances from only the operation and maintenance accounts up to a certain limit. The 1987 bill allowed a one-time transfer of expired 1983 procurement balances into the currency fluctuation account.

CBO did not score budget authority or outlays at either time because there was no decisive evidence that the authority would be used. In 1983 the trend of exchange rates was favorable to the United States so it was unlikely that this new authority would be used. In fact, the Administration's request was reduced by both the House and the Senate Appropriations Committees in the expectation that the rates would remain favorable. Though the trend of exchange rates was unfavorable in 1987, it was not much worse than the Administration anticipated in its budget request. This is not the case this year as Secretary Carlucci has testified.

QUESTIONS FROM SENATOR INOUYE

Projected Economic Slowdown

Question: What is the basis for the CBO projection of a pronounced slowdown in early 1988, and a regaining of strength in the second half of 1988 and 1989?

Answer: The slow growth in real gross national product projected by CBO for the first half of 1988 is based on an inventory correction arising from the production/spending mismatch of late 1987. In the second half of 1987, production greatly exceeded spending, and inventory accumulation was abnormally high. CBO expects that producers will scale back production in the first half of 1988 to work off some of these inventories.

Private forecasters generally agree with the growth path CBO expects, and with the composition of final demand we are forecasting during the 1988 to 1989 period. CBO is close to the *Blue Chip* consensus of major forecasters for both year-over-year growth in 1988 and 1989, and the quarterly pattern.

Question: CBO predicts a pronounced slowdown in domestic growth in early 1988, but that the economy will regain strength in the second half of 1988 and in 1989. How much of this growth assumption is dependent on increased exports to less developed countries?

Answer: Forecasting foreign growth rates is always risky and is especially so this year for a number of reasons. In the industrial countries, the financial market turmoil of 1987 and uncertainty over economic policy may result in growth being below even the modest rates assumed for our forecast. Moreover, a global growth slowdown could precipitate further debt-financing problems among a number of our principal developing-country customers. Such problems could slow or even completely halt their growth. Though this would reduce the growth of U.S. exports, it would not significantly affect the forecast growth of GNP.

However measured, the contribution to real GNP growth of gross U.S. exports to less developed countries will be virtually nil in the first half of 1988. Thereafter, when looking at direct effects only, real gross exports to less developed countries will account for only about 0.1 percentage point of the real GNP growth rate (at an annual rate) in the second half of 1988 and throughout 1989. This is the result of relatively slow (or, in some cases, negative) growth of exports to some developing countries with large external debts and some oil-exporting developing countries--although there has been a rapid growth in exports to the newly industrialized countries (NICs) of Asia and other developing countries. Rapid growth in exports to these countries is partially the consequence of their relatively high rates of economic growth, and partially the consequence of the dollar falling against the currencies of some of the Asian NICs.

Exchange Rates and Inflation

Question: In the light of recent indications from the Administration that they would prevent any further precipitous decline in the dollar, how might your prediction of inflation change?

Answer: The CBO economic forecast assumes that the dollar will fall over the next two years, but not necessarily that there will be any episodes of precipitous decline. However, large exchange rate movements often occur in jumps rather than smoothly over an extended period.

It is certainly possible that the dollar will remain at its current level for the next year or so, though this is not CBO's estimate of the most likely outcome. This would leave the dollar at the end of 1989 about 11 percent higher relative to the currencies of other major industrial countries than CBO has recently forecasted. In that case, assuming that import prices and consumer prices continue to respond to the exchange rate as they have done in the past, the increase in the Consumer Price Index over the next three years would be likely to average about 0.4 percentage points less than in the CBO forecast--or about 4.3 percent instead of 4.7 percent. The largest reduction in CPI growth would be in 1989.

In this scenario, the CPI would still grow faster in 1988 and 1989 than it did in 1987 (3.6 percent), even though the decline in the dollar had ended. This is because the fall in the dollar through the end of 1987 is expected to produce increases in non-oil import prices and in consumer prices that have not yet materialized. Other changes--for instance, a continuation of the recent weakness of oil prices--could also mean lower prices than in the CBO forecast.

Effect of Dollar Depreciation on Spending

Question: The CBO projects that "the dollar is likely to fall further" in the coming months. This current cycle of decline in the exchange rate has resulted in a drop in the purchasing power of U.S. foreign assistance, thereby delaying, or otherwise obstructing, our foreign assistance policy. What does CBO project will be the impact of the dollar decline on outlays? Will weaker dollars spend slower?

Answer: Shifts in the projected exchange rate will have little effect on the purchasing power of U.S. foreign assistance for two reasons. First, most bilateral foreign assistance is used to purchase goods and services in the United States. Second, the dollar is projected to depreciate against the currencies of our major trading partners, not against the currencies of countries that receive U.S. foreign asistance.

For the same reasons, the projected decline in the exchange rate will not affect estimated outlays for foreign assistance programs. CBO does not use exchange rates for estimating outlays for any foreign assistance account.

Effects of Lower Oil Prices

Question: How do the benefits to U.S. consumers of a lower price for imported oil compare with the apparent impact of a slowdown in petro-dollar recycling and the corresponding reduction in the purchase of American-made products by many oil-producing states?

Answer: Lower oil prices have a number of economic effects, not all of them beneficial to the U.S. economy. A lower price for imported oil increases real incomes at home, improving the welfare of consumers. It also lowers the costs for producers who use oil or oil-derived products as raw materials. But there is a significant oil-producing sector in the U.S. economy that is hurt when oil prices fall.

On the international side, there are also both positive and negative effects of an oil price decline. A lower oil price means lower incomes for oil-producing countries, since demand for oil is unlikely to increase proportionately to the price decline, at least in the short run. Lower incomes will reduce the demand for United States exports in these countries. In addition, some low-income oil-producing countries have severe debt problems and may require increased financing from the U.S. and other developed countries during a period of adjustment to the lower oil prices.

Offsetting these negative international aspects is the potential for greater U.S. exports to developing oil-consuming countries which, like the United States, also experience an increase in real incomes when oil prices fall. In addition, a lower oil import bill should enable some countries with balance-of-payments problems to increase imports of non-oil merchandise, benefiting exporters in the United States. And, of course, a lower oil import bill for the United States lowers our current account deficit, thereby stimulating aggregate demand.

Sorting out the economic impacts of all of these competing effects would involve a detailed economic analysis requiring a substantial amount of time. But it is possible to assess the rough orders of magnitude of some of these effects using information and estimates that are currently available.

When the price of oil dropped precipitously in early 1986, CBO performed a summary analysis of the effects of the oil price fall (CBO Staff Memorandum, "The Economic and Budgetary Consequences of the Recent Oil Price Decline," March 1986) by comparing the economic impact of lower oil prices simulated by three commercial econometric models. These models focus primarily on the U.S. economy, and so do not fully incorporate the feedback effects of the lower world oil prices on foreign incomes and thereby on the demand for U.S. export goods. In fact, they do not fully reflect all of the domestic impacts of lower oil prices within the U.S. economy. (See footnote, p. 18.)

Nevertheless, this study is useful in that it offers an order-of-magnitude estimate of the impact of a sizable drop in oil prices on U.S. aggregate income. The study simulated the GNP effect of an $8 per barrel drop in oil prices from baseline values that were in the $20 to $23 per barrel range and found that GNP ranged from 0.5 percent to 3.5 percent higher than the baseline values after two years, with an average increase of 1.9 percent. Of course, the economic conditions prevailing in 1986 are not the same as those we face in 1988, but these figures are only meant to be illustrative of the approximate GNP impact that might be expected from such a price decline.

To get the full picture would require much more detailed modeling of the impact of oil price changes on both oil-exporting and oil-importing countries, in particular focusing on their propensities to import U.S. products. Lacking that, history can give some idea of the potential impact of oil price changes on U.S. exports.

While some industrial countries are significant oil producers and exporters, none rely to such an extent on their oil exports that a reduction in oil prices would severely constrain their ability to purchase U.S. goods. This leaves the developing-country oil exporters as the primary focus. Of these, Mexico and the OPEC countries are the most important for U.S. exports.

At their peak in 1981, U.S. exports to OPEC and Mexico amounted to 17 percent of total U.S. merchandise exports and 1.3 percent of U.S. GNP. In contrast, in 1987, the share of such merchandise exports had fallen to 10 percent of the total, or 0.6 percent of U.S. GNP. The bulk of the drop came in exports to OPEC, which fell by more than half over this period, from 9 percent of U.S. exports to 4 percent. Mexico's imports of U.S. goods also fell, but were on the whole more stable.

There are several reasons why it is unlikely that exports to OPEC and Mexico would drop by a similar amount if oil prices were to fall permanently below their current projected levels. The first is that the drop in U.S. exports to these countries coincided not only with the gradual downward drift in oil prices and oil surpluses, but also with the period of the high dollar. Also, the third-world debt crisis lowered U.S. exports to Mexico. Therefore it is not clear how much of the drop was due to falling oil prices and how much to other factors. In contrast, the current cheap dollar should generate a shift toward U.S. goods, helping to offset the impact of a general decline in total imports by the oil exporters.

A drastic cutback in oil-exporting country imports is also unlikely because, after the first wave of cutbacks, the remaining imports are likely to contain a greater proportion of essential goods than formerly. It will be harder to reduce these imports to the same degree without hurting the domestic economies. As a result, it seems unlikely that U.S. exports to OPEC and Mexico would fall as much as they did from 1981 to 1987.

Even if exports to OPEC and Mexico were to be totally eliminated, U.S. merchandise exports would only fall by 0.5 percent of GNP. This, of course, would be only the immediate impact, but it gives some idea of the worst-case loss from curtailed exports to these countries. When the improbability of such a cutback in exports is taken into account, it appears likely that the losses in reduced exports resulting from a substantial oil price drop would be well below the gains from the cheaper oil.

These rough estimates assume that any drop in oil prices would be permanent. A transitory fall in oil prices would affect exports and incomes to a lesser extent, depending on the size of the fall and the duration of the lower prices expected by producers and consumers.

Question: In CBO's view, what is the range within which the price of im ported oil may fluctuate without placing either inflationary or recessionary pressures on the economy?

Answer: Over the past two years, the price of oil has fluctuated widely, particularly on spot markets that reflect demand not filled by longer-term contracts. At the present time, prices are generally weak, and further weakening is to be expected as the slack season for oil usage approaches. A further fall in oil prices will clearly moderate inflationary tendencies in the short run, and CBO's rough estimate is that the economic benefits from lower oil prices should more than outweigh the losses from reduced exports to oil-producing countries.

Potential problems therefore would only arise if oil prices were to shoot up again. If we assume a benchmark level for the refiners acquisition cost of crude oil of $17 per barrel in 1988 (close to the CBO forecast), then a permanent increase of $2 per barrel, or about 12 percent, could raise the Consumer Price Index by roughly 0.5 percent to 1 percent. This would be a one-time change in the price level; its impact on the rate of inflation would depend, of course, on the time period over which the price change was absorbed.

Such an increase in the price level is unlikely of itself to trigger an inflationary spiral or a recession. Within the past year, oil prices have exceeded $19 per barrel for a brief period before slumping at year end. But during the period of elevated prices, there was speculation that when the OPEC ministers met in December they would raise official prices to $20 per barrel or more. Few economists argued then that such an oil price would necessarily lead either to a renewed inflationary spiral or to recession.

The economic situation is different now, but CBO's forecast for weak economic growth in the first part of the year fortuitously coincides with low oil prices. CBO believes that oil prices are unlikely to recover and reach the $19-$20 per barrel range anytime soon, certainly not before late 1988, when stronger economic growth is expected.

Oil prices above this range are naturally more likely to contribute to inflation. Depending on the strength of the economy and the determination of the Federal Reserve to fight inflation with slower economic growth, such higher oil prices could also increase the chance of recession. CBO does not believe that there is any one trigger price above which the inflation/recession risk rises dramatically. The risk rises with the price. But given the underlying fundamentals of world oil production and consumption, increases well above $20 per barrel anytime soon appear unlikely; if they should occur, they are expected to be temporary. Therefore, the increased risk associated with higher oil prices is mitigated by the decreased probability that price hikes of such magnitude will occur on a permanent basis within the near term.

Third World Debt

Question: What effect would a significant reduction in Third World Debt have on the U.S. trade deficit?

Answer: It would depend on how and how quickly the reduction took place. If it happened slowly and in an orderly manner, for instance with the recognition by creditors of a reduced market value of their assets, debtor countries would need to apply less of their export revenues to covering interest and other charges, and therefore could buy more American goods. This would likely reduce the U.S. trade deficit, though at the expense (in the short run) of a reduction in net interest receipts.

If the reduction in Third World debt happened quickly and in a disorderly manner, for example by widespread repudiation, there could be substantial negative effects on the economies of creditor countries. First, banks everywhere would be reluctant to make new loans to the countries repudiating, which could severely constrain their ability to import. Second, the shock to the financial systems of creditor countries could be severe, as liquidity problems and insolvencies among creditor banks sharply reduced their lending to other customers. Prompt and aggressive action by the central banks of creditor countries would be required in order to prevent sharply higher interest rates. The dollar would also be likely to fall. In such a scenario, it is hard to predict what would be the effect on the trade balance.

Question: What effect would a significant reduction in the Third World debt have on the Federal deficit?

Answer: If a significant reduction in Third World debt were to occur slowly over time, without placing too great a strain on the earning streams of major financial institutions, then the Federal deficit would be affected through three main avenues. One would be through higher U.S. goods exports to the developing countries, and another might be the effect of lower risk in the world financial system on the level of interest rates. Both of these would tend to raise U.S. economic activity, thereby increasing federal tax revenues and lowering federal outlays. And, of course, lower interest rates would mean lower interest payments on the federal debt. Through the third avenue, however, U.S. holders of Third World debt would receive less interest income from abroad. To the extent this happened, it would tend to increase the current account deficit, thereby lowering national income and tending to raise the federal deficit.

Question: By approximately how much would U.S. exports suffer, across all sectors, if the world's most impoverished nations (as defined by the IMF) were to suspend American non-essential imports for one calendar year?

Answer: CBO projects that the United States will export approximately $290 billion of total merchandise goods to the world in 1988 (on a Census basis). Of this, some $90 billion (31 percent) will go to all developing nations. Further disaggregation suggests that $35 billion (12 percent) will go to the countries defined by the International Monetary Fund as heavily indebted, and $2 billion (0.7 percent) to the countries defined as low-income by the World Bank. (This latter category is roughly consistent with the IMF's definition of smaller low-income countries.)

The World Bank's *World Development Report 1987*, Table 12, suggests that of the five categories of imports (food, fuels, other primary commodities, machinery and transport, and other manufactures) for the low-income country group, only the last two categories could be curtailed to any significant extent--that is, classified as nonessential. Roughly 55 to 60 percent of total imports in Table 12 for these countries were from the latter two categories in 1985. As an extreme case, then, one may assume these countries could cut their imports from the United States by 50 percent in 1988. This would represent $1 billion or only 0.4 percent of total U.S. export trade lost to the smaller low-income countries.

While these calculations are necessarily rough, they offer some numbers by which to gauge the most extreme case of curtailed exports to small low-income countries. It is most unlikely that these developing economies could halt totally their imports of such commodities without sustaining unmanageable disruption to their already frail development prospects.

Foreign Military Sales Refinancing

Question: Has CBO revised its estimate of the budgetary impact of foreign military sales (FMS) debt reform? If so, what is the new impact estimate?

Answer: The FMS debt reform program enacted in the Continuing Resolution, P.L. 100-202, contained two elements: a refinancing of the existing FMS loans with U.S. guarantees of 90 percent of the private financing, and an advance appropriation of $270 million to reduce the interest rate on outstanding FMS credits held by the Federal Financing Bank (FFB). CBO has reestimated the budget impact of both elements of the program. The new estimates of the refinancing with new guarantees assume the refinancing will take place later in the fiscal year, lowering the estimate of forgone interest receipts to the FFB by $0.1 billion in 1988. The advance appropriation is conditioned upon a Presidential request for the funds. The President did not request the appropriation in the January budget, and therefore CBO no longer estimates outlays from this appropriation.

Question: What is the CBO estimate on the amount of FMS loans which will be prepaid in 1989? Upon what is this estimate based? Does this estimate differ from that of the OMB? If so, why?

Answer: CBO estimates no FMS refinancing in 1989. The Administration estimates refinancing of $2.3 billion in 1989 and $3.3 billion in 1990. The regulations governing this program will not be promulgated until late March, so both the Administration and CBO estimates are highly speculative. CBO assumes the few debtor countries that can take advantage of the refinancing program will try to maximize their economic benefit from the program. CBO believes this will lead to its completion in 1988.

QUESTIONS FROM SENATOR BUMPERS

The Federal Reserve and Interest Rates

Question: How can we have lower interest rates as OMB has projected unless the Federal Reserve Board abandons its defense of the dollar and its continued fight against inflation?

Answer: The Administration's forecast of interest rates appears to assume that the dollar will remain relatively stable and that investors are relatively sanguine about inflation. CBO believes it unlikely, however, that foreigners will willingly finance our large trade deficit at current exchange rates and interest rates. Private purchasers of dollar assets have generally been (on a net basis) absent from the market for the past two years, and foreign central banks have had to take up the slack. We do not believe that they can continue buying up dollar assets at the present record pace. We therefore believe that the dollar is likely to fall further and that rates are likely to rise.

With respect to monetary policy, our forecast assumes that the central bank will be forced to shift to a less accommodating stance during 1988. There may be little immediate pressure on interest rates, but later in the year we expect that the three-month Treasury bill rate will begin to rise in response to higher inflation, a strengthening in the economy, and a tightening of monetary policy. Similarly, we expect long-term rates to rise as they incorporate expectations of higher inflation. If monetary policy turned out to be substantially looser than we expect, the result would likely be short-term rates below what we forecast. However, long-term rates would likely be higher than CBO forecasts because of greater inflationary fears for the future.

Question: If the Federal Reserve Board abandons its defense of the dollar, won't interest rates rise because we'll have to finance the national debt with U.S. savings?

Answer: One of the first effects of such a policy would be to stimulate inflationary expectations, which would tend to raise interest rates, especially long-term rates. The fear of dollar depreciation would discourage the inflow of foreign capital, which would tend to put further upward pressure on interest rates.

Question: If the Federal Reserve Board does not continue to fight inflation, won't interest rates rise because of investors' fears about the inflation? Isn't this why the Federal Reserve Board raised interest rates last Spring--to reassure the bond market?

Answer: If the Federal Reserve does not continue to fight inflation, short-term interest rates might be pushed down for a while. But soon inflationary expectations would be exacerbated, which would cause interest rates to move higher, especially long-term rates. From the Louvre accord in February 1987 through October 1987, the Federal Reserve's stated aims were to support the value of the dollar and to dampen inflationary expectations. In pursuing these aims, the Federal Reserve was forced to keep up interest rates. After the crash, however, it permitted rates to fall even at the cost of a depreciating dollar. We believe that monetary policy will again become tighter as a result of increases in inflationary pressures, produced in part by the depreciation of the dollar.

OMB's Interest-Rate Projections

Question: We could have lower interest rates if we have a recession (no demand for money), but isn't that the only scenario under which interest rates could be as low as OMB projects them to be?

Answer: We expect that the economy will be fairly weak in the first half of 1988 but that it will gain momentum in the second half of the year and in 1989. If the economy turns out to be much weaker than we expect, then interest rates could be substantially lower than we have forecast. We do not expect a recession to develop during the forecast period, in part because of the stimulus from the trade sector.

The Administration's interest-rate forecast is low compared with CBO's and with most private forecasters, but given the range of uncertainty around interest-rate forecasts the Administration's forecast of rates cannot be ruled out. If inflation turned out to be unexpectedly low, interest rates could be significantly lower than we have forecast. The Administration's forecast of interest rates is among the lowest--but not the lowest--compiled in the *Blue Chip* survey. For instance, of the roughly 50 forecasts surveyed recently, the Administration's forecast for the 90-day Treasury bill rate was equal to the average for the lowest 10 forecasts for both 1988 and 1989.

Question: Can you see any scenario under which OMB's projections on interest rates can come to pass?

Answer: In large part, the difference between CBO and the Administration on interest rates reflects different views about inflation and the outlook for the dollar. CBO and most private forecasters expect consumer price inflation to increase slightly in the near term, while the Administration expects inflation to decline. We expect higher inflation in large part because we believe that the (past and future) depreciation of the dollar will cause the price of imports to rise sharply. If we are wrong about higher import prices, inflation could be significantly lower than we have forecast, and therefore interest rates would also likely be lower.

Question: Isn't the Federal Reserve Board in an almost impossible position regarding interest rates?

Answer: The fate of the economy (and the CBO economic forecast) depends on the success of the Federal Reserve in supplying the economy with enough credit to avoid a recession, but not so much as to reignite inflation and undermine the dollar. This is a difficult task because the margins for error have narrowed considerably. The amount of capital and labor slack is not great. Also, we believe that the depreciation in the dollar since early 1985 has created the potential for substantial inflationary pressures from rising import prices.

Effects of an Average Recession

Question: Could CBO prepare for me figures on the deficit in 1988 and 1989 if the economy slips into an "average" recession this year or an "average" recession next year?

Answer: Recessions differ a great deal in their causes, depth, and duration, and in the behavior of key variables such as interest rates. For that reason there would be little agreement on what constitutes an "average" recession. In the past few weeks, CBO has analyzed the effects on the budget of a number of recession scenarios developed by private forecasters, including Data Resources Inc. (DRI), Wharton Econometric Forecasting Associates (WEFA), and Merrill Lynch Economics. DRI and WEFA are not forecasting a recession; their recession scenarios are alternatives to their standard forecasts. Merrill Lynch, however, in its forecast developed in early February, saw a 1989 recession as likely and included it in its standard forecast. Under these recession forecasts, the 1988 deficit ranged from zero to $20 billion higher, and the 1989 deficit from $10 billion to $40 billion higher, than under CBO's assumptions.

Effects of a Deep Recession

Question: Could CBO prepare for me figures on the deficit in 1988 and 1989 if the economy slips into a recession like the 1982 recession this year or next?

Answer: The 1982 recession was the worst since the Great Depression. Real gross national product (GNP) dropped 2.5 percent in 1982, unemployment averaged 9.5 percent in the same year, and interest rates were high although they dropped from the mid-teen levels that had prevailed before the recession began. If these conditions were to repeat themselves, we estimate that the 1989 deficit would be about $90 billion higher than in CBO's baseline forecast. Nevertheless, even those forecasters who expect a recession do not generally envision such a pessimistic combination of circumstances.

Severity of Another Recession

Question: Could CBO also prepare for me an estimate of its projection on the depth and duration of any recession we would have if we have a recession with the level of government, consumer, corporate, energy, real estate and Third World debt? What are the possibilities that a recession would spiral out of control because the economy is so highly leveraged?

Answer: On average, recessions since the Second World War have lasted 11 months, and the unemployment rate has reached a peak 3.2 percentage points above the level at the end of the growth period preceding the recession. This is the best guess we can make of the likely duration and depth of a recession, if one should occur.

Some might argue that current levels of debt are so large that the dynamics of recessions has been fundamentally altered from historical experience. The arguments have two dimensions: retrenchment by debtors, and default. First, retrenchment by debtors (consumers, corporations, and LDCs) could aggravate any drop in the demand for U.S. output. For example, as real incomes fell in a recession, the overhang of household debt might mean a larger-than-usual cutback in consumer spending. Although such a consumer-demand-led recession has limited precedent, we do not believe that current levels of consumer debt are high enough to affect drastically the likely consumer response to a recession.

Second, default by debtors could cause a liquidity squeeze and lead to higher interest rates. Several sectors in the U.S. financial system (including some thrifts, some banks with high exposure to LDCs and energy-related loans, and some brokerages) remain somewhat fragile. For example, lower growth (and lower imports) in the United States could exacerbate problems of servicing Third-World debt, causing financial strains in U.S. banks that hold the debt. But U.S. banks have made significant strides toward reducing their exposure to Third-World debt in recent years. The Federal Reserve has been closely monitoring the state of the financial system, and has taken steps to provide needed liquidity as appropriate, particularly following the October stock market crisis. For this reason we do not foresee the financial system experiencing important problems of solvency if interest rates remain near forecast levels.

Many recessions since the Second World War have been immediately preceded, and in part precipitated, by an unanticipated sharp rise in interest rates. If short-term interest rates rose abruptly--perhaps because foreigners, and particularly foreign central banks, decided to slow significantly, or to reduce, their accumulation of dollars--problems, including insolvency, could develop quickly in some financial institutions. Whether this would cause a recession, and whether any recession that resulted would be deeper than usual, would depend on the ability of the Federal Reserve to act quickly enough to provide additional liquidity.

In sum, the higher level of debt probably means that any recession will be of above-average severity. But no one, including CBO, can measure the precise incremental effects of the aforementioned factors. If we were forecasting a recession, it would be of the depth and duration noted above.

Could the world economy be retracing the events of the Great Depression? Although a collapse in economic activity of such magnitude cannot be ruled an impossibility, CBO believes that such a scenario has an extremely small probability.

Major structural differences in the economies of 1929 and 1988 argue against a repeat of the early 1930s. There has been a dramatic decline in the importance of the cyclically sensitive agriculture and goods-producing sectors; the government and service sectors, which are less cyclically sensitive, have become much more important. In addition, government programs that increase spending during cyclical downturns have been introduced and expanded. Finally, a banking panic is far less likely today than in the early 1930s because of deposit insurance and the willingness of the Federal Reserve to support troubled banks.

Misguided monetary and trade policies were important factors contributing to the Great Depression. If the lessons of history have been learned, then a repeat of the policy miscues of the 1930s is unlikely. The initial response of the Federal Reserve after the worldwide crash in stock markets in October gives cause for some optimism.

QUESTIONS FROM SENATOR D'AMATO

Proposed Rescission Power

Question: I am drafting legislation that would force Congress to never again pass an Omnibus Continuing Resolution. Under current law, Congress must vote to approve any rescissions in budget authority that the President proposes. If Congress fails to act within 45 days, then the proposed rescissions are not enacted.

My bill would make one simple change: in the case of an Omnibus Continuing Resolution, Congress would have to specifically reject any of the President's proposed rescissions. By dumping a massive continuing resolution on the President's desk, Congress effectively denies the President his veto power. He could veto it, but then the government is shut down. So he signs the bill, despite his reluctance.

Under my bill, Congress would surrender some power to the President in the case of large continuing resolutions. This is only fair since we have effectively denied the President his veto power. This simple change would force Congress to pass the individual appropriations bills rather than give the President enhanced rescission power.

What do you think of my proposal? I know OMB has proposed that Congress specifically vote on all rescissions. But the Senate rejected this proposal by a large margin in 1986.

(You define continuing resolution as a bill containing three or more appropriations measures that are funded through an entire fiscal year.)

Answer: I agree that it would be desirable for regular appropriation bills to be enacted on schedule. The "Continuing Appropriations Rescission Act of 1988" has been proposed in hope of giving an incentive to the Congress to pass appropriation bills on time. The Act would give the President statutory authority to rescind amounts appropriated in continuing resolutions, unless the Congress passed bills disapproving such rescissions. Given the Supreme Court's holding in the *Chahda* decision that disallowed changes in the constitutionally prescribed process of lawmaking, the proposed procedure would probably be constitutionally suspect.

Assuming, however, that the bill would be constitutional, it is not clear that it would prevent the Congress from passing continuing resolutions in the future. If recent public statements by Members and Senators are any indication, the Congress dislikes continuing resolutions as much as the President. It has relied on them only because of the difficulty in reaching a budget agreement with the President when there have been many significant policy differences between the branches.

In addition, it seems unlikely that the Congress has used continuing resolutions in order to deny the President the use of the veto. The President still has the opportunity to veto a proposed continuing resolution while blaming the Congress for passing a bill that wasn't fit for his signature. Recent short-term resolutions have reflected this, for they have been bare of the type of projects that the President has called "pork-barrel." Long-term "continuing resolutions," which are more accurately called "omnibus appropriation bills," have included such projects, but only after long, involved negotiations in which the President has been a full participant.

The rescission power that would be granted to the President could actually promote the use of continuing resolutions. If the President were to veto regular appropriation bills in the hope that the Congress would have to pass a continuing resolution, he could then use his enhanced power to rescind amounts--a power he would not have for regular appropriation bills.

CBO and OMB Forecasts

Question: How much weight will OMB give CBO's economic forecast when you determine if a sequester is in order? Will CBO's economic projection be used only as a suggestion? Will OMB average its forecast with CBO's forecast?

Answer: CBO cannot predict what OMB will do when it prepares an economic forecast for its next report under the Balanced Budget Reaffirmation Act. If past experience is a guide, however, OMB's forecast in August will closely resemble the Administration's current economic forecast with revisions only for the intervals covering the period up to June or July 1988 to reflect actual data.

CBO and OMB Deficit Forecasts

Question: Could you break down the components of the disparity between CBO's deficit forecast and OMB's deficit forecast? How much of it is from different economic projections? How much is derived from Congressional actions that OMB has proposed that CBO does not take into account? How much impact does a 1% change in GNP have on the deficit?

Answer: CBO's report, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1989*, explains why our estimates of revenues, outlays, and the deficit differ from the Administration's. The differences for fiscal year 1989 break down as follows:

Deficit Under Current Policies (CBO Estimate)	$177 billion
Deficit Reductions Proposed by Administration (CBO Estimate)	-12 billion
Deficit Under Administration Policies (CBO Estimate)	165 billion
Estimating Differences:	
Economic	-25 billion
Technical	-11 billion
Deficit Under Administration Policies (OMB Estimate)	130 billion

As shown in the table, the Administration proposes $12 billion of deficit reduction for fiscal year 1989; most would require action by the Congress. About half of the deficit reduction comes from the sale of assets, and the remainder from savings in defense and nondefense programs and some modest revenue proposals.

CBO estimates that, even if all of the Administration's proposals were enacted, the 1989 deficit would be $165 billion--well above the Administration's estimates. $25 billion of the difference stems from assumptions about the economy. CBO forecasts slower real growth, higher inflation, and higher interest rates than does the Administration. The remaining $11 billion comes from technical reestimates, where CBO believes the Administration has overstated revenues and understated outlays in a variety of areas such as deposit insurance, Medicare, and income security programs.

Estimates of federal government revenues and spending are very sensitive to economic assumptions. Our earlier report, *The Economic and Budget Outlook: Fiscal Years 1989-1993*, presented rules of thumb for the effects of changes in individual economic variables on budget estimates. As shown in that report, a one-percentage-point lower rate of growth in real gross national product would increase the 1988 deficit by about $6 billion and the 1989 deficit by about $21 billion.

Tax Rate Indexing

Question: As part of the 1981 tax bill, Congress enacted the indexing of tax rates, the personal exemption and standard deduction. At that time, there were 13 tax brackets for individuals and double digit inflation. As a result, taxpayers could be easily pushed into a higher tax bracket just because of inflation (bracket creep).

Inflation is now around 3% or 4%. Tax reform reduced the number of tax rates to 3 (15%, 28%, and 33%). I do not think indexing is needed anymore.

How much does income tax indexing cost the treasury each year? Over 3 years? Over 5 years? How much does a 1% increase in the CPI cost the treasury because of income tax indexing?

Answer: If the tax code was modified so that there would be no indexing of tax brackets, standard deductions, and personal exemptions, revenue would increase by the following amounts in fiscal years 1989 through 1993 (in billions of dollars):

Fiscal Year						
1989	1990	1991	1992	1993	1989-1991	1989-1993
3.7	12.0	23.6	36.9	51.6	39.3	127.8

Indexing by an additional one percentage point in 1989 would reduce revenues by about $1 billion in fiscal year 1989 and by about $2 billion in fiscal year 1992.

Question: Should we delay indexing from 1989 to 1990 as part of a package that also cuts spending below the levels agreed to last year? The public is willing to accept a change in indexing.

Answer: The Congressional Budget Office does not make policy recommendations, but CBO recently examined the issue of income tax indexing in *Reducing the Deficit: Spending and Revenue Options.* Following is the analysis of options to delay or repeal indexing included in that volume.

Addition to CBO Baseline	Annual Added Revenues (In billions of dollars)					Cumulative Five-Year Addition
	1989	1990	1991	1992	1993	
Delay Indexing Until 1990	3.7	6.1	6.6	7.1	7.6	31.0
Repeal Indexing	3.7	12.0	23.6	36.9	51.6	127.8

Under current law, the personal exemption amount (for years after 1989), and the standard deduction and tax bracket widths are adjusted annually to offset the effects of inflation (indexed). The Tax Reform Act of 1986 set the dollar amounts of the standard deduction (which replaces the zero bracket amount) and the tax brackets for 1988, and the dollar amount of the personal exemption for 1988 and 1989. The act also indexed the amount and phaseout level of income for the Earned Income Credit (EIC) for the first time.

Repealing indexing except for the EIC would raise revenues by about $128 billion in 1989 through 1993, assuming that inflation will average 4.6 percent over the period. Revenues from repealing indexing would grow rapidly because of the cumulative effects of inflation. Delaying indexing by eliminating only the indexing adjustment scheduled for 1989 would raise revenues by about $31 billion in the same period.

Repealing or delaying indexing would raise the taxes of most taxpayers but would not increase taxes for families that have very high incomes and itemize their deductions, because the tax liabilities of these families do not de-pend on the personal exemption or the 15 percent bracket. (The benefits of both personal exemptions and the 15 percent bracket are phased out for high-income taxpayers.) For taxpayers with incomes below the top tax bracket, eliminating indexing would raise tax liabilities by a greater percentage for families that use the standard deduction (generally low- and middle-income families) than for families that itemize deductions.

One argument for retaining indexing is that it requires the Congress to decide explicitly on tax increases. Without indexing, inflation causes many taxpayers to move into higher tax brackets, so that tax liabilities increase at a faster pace than income. This results in an increase in real tax liabilities without legislative action even for taxpayers with no increase in real income. Some people argue that these automatic tax increases give legislators an incentive to pursue inflationary policies and that indexing protects against this bias.

CONCLUSION OF HEARINGS

Chairman STENNIS. The committee will now take a recess. Is there any other matters to be taken up now?

[No response.]

Chairman STENNIS. We will take a recess now subject to the call of the chair.

[Whereupon, at 11:30 a.m., Friday, March 4, 1988, the hearings were concluded and the committee was recessed, to reconvene at the call of the Chair.]

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